TEST ITEM FILE - SOLUTIONS

Byrd & Chen's Canadian Tax Principles
2016 - 2017 Edition

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Problem Concordance

A concordance of the problems in the 2015/16 vs. 2016/17 editions is available to assist instructors who have previously used ***Canadian Tax Principles***.

Bookmarks In PDF File

To assist you in navigating through the electronic version of this solutions manual, there are bookmarks on the first page of each Assignment Problem solution.

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Chapter One Test Item File Solutions

TIF Solution One - 1

1. The other sources of federal revenues that are shown in Figure 1-1 of the text are:
   - Corporate income taxes.
   - Non-resident income taxes.
   - GST.
   - Customs and import duties.
   - Other excise taxes.
   - EI premiums.

2. In the *Income Tax Act*, the term "person" can refer to an individual, a corporation, or a trust.

3. Provincial income taxes on individuals are calculated by applying a provincial rate schedule to the same Taxable Income figure that is used to calculate the federal income tax for individuals. Provincial credits are then applied to the resulting figure. The provincial brackets may differ from the federal brackets. In addition, provincial credits may be different than the federal credits.

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

5. Examples provided in the text are as follows:
   - Tax revenues are used to provide public goods and services.
   - Excise taxes are used to discourage the consumption of alcohol and tobacco products.

   There are, of course, many other examples that could be cited.

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

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

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

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

10. The reasons that are listed in the text are as follows:

- It is less costly to administer tax expenditures than it is to administer government funding programs.
- More decisions are left to the private sector so that funds may be allocated more efficiently.
- Tax expenditures reduce the visibility of certain government actions. This is particularly beneficial if some social stigma is attached to the programs. For example, a child tax benefit system is more acceptable than increasing social assistance payments.
- Tax expenditures reduce the progressivity of the tax system. As many of the tax expenditures, such as tax shelters, are more available to higher income taxpayers, they serve to reduce effective tax rates in the higher rate brackets.

11. This situation reflects the fact that when a new Section is added, it has been more convenient to attach a decimal designation to the new Section, as opposed to renumbering all of the Sections that follow the new Section. As an example, over several years, the Department of Finance has added five new Sections after Section 12. They have been numbered Section 12.1 through Section 12.5. If they had used whole numbers for these new Sections, it would have been necessary to renumber all of the remaining Sections in the *Act* each time a new Section was added.

12. The purposes of these treaties are as follows:

- They attempt to avoid double taxation of taxpayers who may have reason to pay taxes in more than one jurisdiction.
- They try to prevent international evasion of taxes.

13. The required four items can be selected from the following:

- CRA Web Site
- Interpretation Bulletins
- Income Tax Folios
- Information Circulars
- Income Tax Technical News
- CRA News Releases, Tax Tips, and Fact Sheets
- CRA Guides
- CRA Pamphlets
- Advance Income Tax Rulings
- Technical Interpretations

14. For individuals and inter vivos trusts, the taxation year is equal to the calendar year. In contrast, corporations can always use a fiscal period. A fiscal period can end on any date, with the only constraint being that it cannot exceed 53 weeks for a corporation. With respect to testamentary trusts, prior to 2016, like corporations, they could always use a non-calendar fiscal year. In 2016 and subsequent years, their use of non-calendar fiscal periods is significantly restricted (see Chapter 19).

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

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

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

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

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

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

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

TIF Solution One - 2

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

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

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

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

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

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

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

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

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

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

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

12. True. While individuals and inter vivos trusts must use a calendar taxation year, other taxpayers can choose to use this period as their taxation year. Note that, beginning in 2016, testamentary trusts must also use a calendar taxation year.

TIF Solution One - 3

New For 2016/2017

1. C. Head Tax

2. B. Extremely high rates of tax will always encourage individuals to work harder so that they will have more after tax income.

3. D. The *Income Tax Act* is the most important source of information for dealing with matters related to the federal income tax.

4. B. Corporations must use the calendar year as their taxation year.

5. C. Net Income For Tax Purposes requires that costs be matched with revenues.

6. D. If a business loss exceeds all other positive sources of income, Net Income For Tax Purposes is equal to nil.

7. B. A deduction for the extra costs related to living in prescribed areas of the Canadian north.

8. C. Accelerated depreciation (CCA) on rental properties.

Retained From Previous Editions

9. C. Walters and Walters, a group of CPAs operating as a partnership.

10. D. All of the above could be required to file a GST return.

11. A. Personal income tax

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

13. C. Individuals, trusts and corporations

14. B. Provincial, federal, and international

15. C. Ensure fairness in the allocation of resources to different levels of government.

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

17. B. A regressive tax is one which results in lower effective tax rates for higher income taxpayers.

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

19. B. Inelasticity.

20. C. Simplicity.

21. A. Neutrality.

22. D. Horizontal equity.

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

24. B. Income Tax Folios.

25. C. Dominion Tax Cases.

26. C. Unreported revenues from business transactions.

27. B. The Income Tax Regulations.

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

29. A. is a resident of Canada.

30. D. Bunly Im, a resident of the United States who earns interest income in Canada.

31. C. Rental income earned in Canada

32. B. Net income is determined by adding together several different types of income which are added together based on an ordering rule.

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

34. C. $45,000

35. B. $ 22,000 ($34,000 + $4,000 - $2,000 - $14,000)

36. B. Nil, with a business loss that can be used in either the previous 3 years or in the next 20 future years of $12,000 (34,000 + 6,000 + 4,000 – 2,000 – 54,000)

37. B. That the current year allowable capital losses can only be deducted to the extent that there are taxable capital gains during the current year.

38. D. The excess of allowable capital losses over taxable capital gains for the year.

39. D. Tax avoidance.

40. B. Tax deferral.

TIF Solution One - 4

Exam Exercise One - 1 Solution (Taxable Entities For Income Tax Purposes)

Sally Forbes, the Forbes family trust, and Forbes Enterprises Ltd. could be required to file income tax returns. Forbes Boutique, Forbes and Delaney, and the Forbes Foundation are not taxable entities for income tax purposes.

Exam Exercise One - 2 Solution (Taxable Entities For GST Purposes)

Under the GST legislation, all of the listed entities could be required to file a GST return. Where only individuals, corporations and trusts can be required to file an income tax return, the definition of a person (i.e., taxable entity) is much broader for GST purposes. As is explained in detail in Chapter 21, whether an entity is required to file a GST return is dependent on the level of commercial activity.

Exam Exercise One - 3 Solution (Federal And Provincial Taxes Payable)

Federal Tax Payable [(15%)($37,500)]	$5,625
Provincial Tax Payable [(8.2%)($37,500)]	3,075
Total Tax Payable [(15% + 8.2%)($37,500)]	$8,700

Exam Exercise One - 4 Solution (Federal And Provincial Taxes Payable)

Federal Tax Payable [(15%)($26,700)]	$4,005
Provincial Tax Payable [(10%)($26,700)]	2,670
Total Tax Payable [(15% + 10%)($26,700)]	$6,675

Exam Exercise One - 5 Solution (Regressive Taxes)

Samantha's HST paid totals $28,080 [(13%)($216,000)]. Based on her Taxable Income of $625,000, this would represent an effective rate of 4.5 percent ($28,080 ÷ $625,000).

Martha's HST paid totals $2,782 [(13%)($21,400)]. On her Taxable Income of $12,000, this would be an effective rate of 23.2 percent ($2,782 ÷ $12,000).

Exam Exercise One - 6 Solution (Regressive Taxes)

Veronica's HST paid totals $21,060 [(13%)($162,000)]. Based on her Taxable Income of $843,000, this would represent an effective rate of 2.5 percent ($21,060 ÷ $843,000).

Her sister's HST paid totals $4,680 [(13%)($36,000)]. On her Taxable Income of $8,000, this would be an effective rate of 58.5 percent ($4,680 ÷ $8,000).

Exam Exercise Solution One - 7 (Non-Resident Liability For Tax)

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

Exam Exercise One - 8 Solution (Non-Resident Liability For Tax)

He is not correct. Under ITA 2(3) he would be subject to Canadian taxes on the gain resulting from a disposition of Taxable Canadian Property.

Exam Exercise Solution One - 9 (Net Income For Tax Purposes)

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

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

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

Exam Exercise One - 10 Solution (Net Income For Tax Purposes)

Mr. Nicastro's Net Income For Tax Purposes would be calculated as follows:

Income Under ITA 3(a):		
Net Employment Income	$45,000	
Interest Income	4,500	$49,500
Income Under ITA 3(b):		
Taxable Capital Gains	$13,500	
Allowable Capital Loss	(18,200)	Nil
Balance From ITA 3(a) And (b)		$49,500
ITA 3(c) Deductions:		
Spousal Support		(24,000)
Balance From ITA 3(c)		$25,500
Deductions Under ITA 3(d):		
Business Loss		(23,000)
Net Rental Loss		(14,500)
Net Income For Tax Purposes		Nil

At the end of this year, Mr. Nicastro would have an unused allowable capital loss carry over of $4,700 ($13,500 - $18,200). In addition, he would have a non-capital loss carry over of $12,000 ($25,500 - $23,000 - $14,500).

Exam Exercise Solution One - 11 (Tax Planning)

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

Exam Exercise One - 12 Solution (Tax Planning)

This transaction involves tax avoidance. Ms. Bloom can receive this benefit from her employer without being assessed a taxable benefit. Extra salary would be taxable.

Exam Exercise Solution One - 13 (Tax Planning)

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

Exam Exercise One - 14 Solution (Tax Planning)

Contributions to a registered pension are deductible in the year in which they are made. They are not taxed until retirement benefits are received under the terms of the plan. This involves tax deferral and, if Ms. Jones is taxed at a lower rate after she retires, tax avoidance has also been accomplished.

Exam Exercise Solution One - 15 (Tax Planning)

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

Exam Exercise One - 16 Solution (Tax Planning)

This transaction involves income splitting. As Norman's son is over 18 years of age, the dividends will be taxed in his name and not attributed back to his father. Provided he is in a lower tax bracket than Norman, this will reduce the family's overall tax burden.

TIF Solution One - 5A

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

A. 1

B. 8

C. 9

D. 3

E. 5

F. 2

G. 6

H. 7

The two unused definitions are as follows:

Income Tax Folios = 4

Progressive Tax System = 10

TIF Solution One - 5B

For some terms there is both a 100 percent correct answer and an answer that is close. We have indicated the “close answer” in brackets.

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

A. 1 (not 12)

B. 10

C. 13

D. 4 (not 7)

E. 6 (not 11)

F. 3 (not 14 which is also an unused definition)

G. 8

H. 9 (not 2)

The two unused definitions are as follows:

Income Tax Folios = 5

Progressive Tax System = 14

TIF Solution One - 6

While there is not one "correct" solution to this problem, the following solution contains comments on each of the listed qualitative characteristics.

Equity Or Fairness The toll is clearly regressive in nature in that it is assessed almost exclusively on lower income individuals. In general, regressive taxes are viewed as being less fair. While the toll has horizontal equity (individuals with the same Taxable Income would pay the same amounts), it lacks vertical equity (the higher income residents of the island would not normally be subject to the tolls).

Neutrality The concept of neutrality calls for a tax system that interferes as little as possible with decision making. The toll may influence employment decisions. If the non-residents have off-island employment opportunities, they may choose not to work on the island.

Adequacy While we do not have any information on this, it would be safe to assume that the toll was established at a level that would be adequate for the funding requirements related to the bridge.

Elasticity Tax revenues should be capable of being adjusted to meet changes in economic conditions, without necessitating tax rate changes. It is not clear from the problem whether economic conditions would influence the number of individuals who work on the island and pay the toll.

Flexibility This refers to the ease with which the tax system can be adjusted to meet changing economic or social conditions. The tolls can be easily adjusted and, thereby get high marks for this characteristic.

Simplicity And Ease Of Compliance A good tax system is easy to comply with and does not present significant administrative problems for the people enforcing the system. The toll would receive high marks in this regard.

Certainty Individual taxpayers should know how much tax they have to pay, the basis for payments, and the due date. There is no uncertainty associated with a clearly posted toll rate.

Balance Between Sectors A good tax system should not be overly reliant on either corporate or individual taxation. The toll is, of course, totally reliant on the taxation of individuals.

International Competitiveness If a country's tax system has rates that are out of line with those in comparable countries, the result will be an outflow of both business and skilled individuals to those countries that have more favourable tax rates. Although international competitiveness would not appear to be an issue with the toll, it would affect the ability of the city to maintain and attract workers.

TIF Solution One - 7

If this problem is used on an examination, great flexibility will be required in marking the student's responses. There is obviously no one solution to this problem and, given this, marks will have to be allocated on the basis of the reasonableness of the student's answers.

We would also note that we do not present the following as a comprehensive solution. It simply reflects some of the points that could be made with respect to the alternatives that are described in the text. The list of characteristics is as follows:

- Equity Or Fairness
- Neutrality
- Adequacy
- Elasticity
- Flexibility
- Simplicity And Ease Of Compliance
- Certainty
- Balance Between Sectors
- International (Provincial in this case) Competitiveness

Alternative 1

The following comments could be made with respect to this alternative:

Adequacy The introduction of a provincial sales tax (PST) could provide adequate revenues to solve the deficit problem.

Neutrality Whether a sales tax would be neutral would depend on its application. If it applied to all goods and services, it could be considered neutral. However, if it provides exemptions for certain types of goods and services (an exemption for basic food products), it would influence the allocation of resources.

Fairness As noted in the text, sales taxes of any type are regressive and this can be viewed as unfair to lower income individuals.

Certainty Sales taxes make it clear to individual taxpayers the amounts that will have to be paid. However, certainty can be compromised if the application of the sales tax involves numerous exemptions.

Ease Of Compliance Here again, it depends on how the tax is applied. If it applies to all goods and services, compliance is not too difficult. However, compliance could become very complex if various types of exemptions are available. Also increasing complexity would be variances between the application of this tax and the application of the federal GST.

Alternative 2

The following comments could be made with respect to this alternative:

Adequacy, Neutrality, Fairness, And Certainty The comments on alternative 1 would be applicable here.

Ease Of Compliance The major advantage of this Alternative over Alternative 1 is ease of compliance. When there is a separate PST, taxpayers will have to file both a GST return and a PST return. Note, however, when a province chooses to apply HST to different items than those covered by the GST legislation, compliance is made more difficult.

Alternative 3
The following comments could be made with respect to this alternative:

Adequacy Cuts in expenditures can provide for the required deficit reduction.

Ease Of Compliance As the subject of the cuts have little choice in the matter, compliance is not an issue. However, implementation could present many problems for targeted organizations, particularly if the cuts are not anticipated.

Fairness This alternative is targeted at the needs of students. This could be viewed as favouring older individuals who are not participating in educational programs and/or do not have children involved in educational programs.

Provincial Competitiveness University students have considerable mobility and could decide to search for positions in the universities of other provinces. However, they may be faced with higher out-of-province tuition, as well as the costs of living away from home. With respect to families with children in elementary or high school, a decline in the quality of schools could discourage immigration to the Province.

Alternative 4
The following comments could be made with respect to this alternative:

Adequacy And Ease Of Compliance The comments on Alternative 3 would be applicable here.

Fairness The impact of this change would be broadly based. However, it could be viewed as being unfair to those individuals with health problems. It is likely that the impact of cuts in health care would be felt most by older individuals. There is an additional fairness question in terms of whether the current health care system is adequately funded. If it is not, then the proposed cuts could be unfair to everyone with health problems.

Alternative 5
The following comments could be made with respect to this alternative:

Adequacy It is likely that the introduction of progressive rates on individuals would assist with deficit reduction. Note, however, that an offsetting factor could be that individuals are less willing to work more when the result will be a higher rate of tax.

Ease Of Compliance As discussed in the text, progressive rates add complexity and encourage evasion.

Fairness Most analysts view progressive rates as being fair in that individuals with higher income will have higher rates. The basis for this argument is ability to pay.

Alternative 6
The following comments could be made with respect to this alternative:

Adequacy Increases in corporate tax rates could contribute to deficit reduction.

Ease Of Compliance Given that corporate income tax is already in place, an increase in rates would not add to compliance issues.

Balance Between Sectors This change would result in heavier reliance on the corporate income tax, as compared to the amounts resulting from the application of the individual income tax. Without knowing the current balance between these two sectors, it is difficult to comment on this change.

Provincial Competitiveness If the increase in the corporate tax rate results in a rate that is higher than other provinces, the result could be some loss of corporate business in Alsaskatoba.

Alternative 7

The following comments could be made with respect to this alternative:

Adequacy Provided this fee did not discourage immigration to Alsaskatoba, this fee could help reduce the deficit.

Fairness There is an argument, based on the fact that new immigrants use provincial resources, (e.g. health care for example), that such a tax would be fair to the current residents of Alsaskatoba.

Provincial Competitiveness This fee will clearly discourage immigration, making it more difficult to attract individuals from other provinces.

There are, of course, many other comments that could be made on all of these alternatives. We would also note that there is another issue with respect to all of these alternatives. This is the question of political acceptability. If the residents of Alsaskatoba have never had a sales tax, this alternative may not be acceptable, without regard to other considerations.

TIF Solution One - 8

Case A

The Case A solution would be calculated as follows:

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

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

Case B

The Case B solution would be calculated as follows:

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

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

TIF Solution One - 9

Case A

The Case A solution would be calculated as follows:

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

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

Case B

The Case B solution would be calculated as follows:

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

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

TIF Solution One - 10

Case A

The Case A solution would be calculated as follows:

Income Under ITA 3(a):		
Employment Income	$34,000	
Income From Property	21,000	$55,000
Income Under ITA 3(b):		
Taxable Capital Gains	$42,000	
Allowable Capital Losses	(57,000)	Nil
Balance From ITA 3(a) and (b)		$55,000
Subdivision e Deductions		(5,500)
Balance From ITA 3(c)		$49,500
Deduction Under ITA 3(d):		
Business Loss		(36,000)
Net Income For Tax Purposes (Division B Income)		$13,500

Miss Bain would have a carry over of unused allowable capital losses in the amount of $15,000 ($57,000 - $42,000).

Case B

The Case B solution would be calculated as follows:

Income Under ITA 3(a):		
Employment Income	$18,500	
Income From Property	12,000	$30,500
Income Under ITA 3(b):		
Taxable Capital Gains	$ 9,000	
Allowable Capital Losses	(12,000)	Nil
Balance From ITA 3(a) and (b)		$30,500
Subdivision e Deductions		(10,500)
Balance From ITA 3(c)		$20,000
Deduction Under ITA 3(d):		
Business Loss		(28,200)
Net Income For Tax Purposes (Division B Income)		Nil

As Miss Bain's business loss exceeds the balance from ITA 3(c), her Net Income For Tax Purposes (Division B income) is nil. This means there would be a carry over of unused business losses in the amount of $8,200 ($28,200 - $20,000) and of unused allowable capital losses in the amount of $3,000 ($12,000 - $9,000).

TIF Solution One - 11

Case 1

The Case 1 solution would be calculated as follows:

Income Under ITA 3(a):		
Net Employment Income	$82,438	
Interest Income	3,521	$85,959
Income Under ITA 3(b):		
Taxable Capital Gains	$16,346	
Allowable Capital Losses	(3,478)	12,868
Balance From ITA 3(a) And (b)		$98,827
RRSP Contribution		(6,420)
Balance From ITA 3(c) And Net Income For Tax Purposes		$92,407

In this Case, Mr. Bowman has no loss carry overs at the end of the year.

Case 2

The Case 2 solution would be calculated as follows:

Income Under ITA 3(a):		
Net Business Income		$56,782
Income Under ITA 3(b):		
Taxable Capital Gains	$3,426	
Allowable Capital Loss	(4,560)	Nil
Balance From ITA 3(a) And (b)		$56,782
Spousal Support Payments		(18,000)
Balance From ITA 3(c)		$38,782
Deduction Under ITA 3(d):		
Net Rental Loss		(6,742)
Net Income For Tax Purposes (Division B Income)		$32,040

In this Case, Mr. Bowman has a carry over of $1,134 ($4,560 - $3,426) in unused allowable capital losses.

Case 3

The Case 3 solution would be calculated as follows:

Income Under ITA 3(a):		
Net Employment Income		$36,582
Income Under ITA 3(b):		
Taxable Capital Gains [(1/2)($8,426)]	$4,213	
Allowable Capital Losses [(1/2)($6,220)]	(3,110)	1,103
Balance From ITA 3(a) and (b)		$37,685
Child Care Costs		(2,860)
Balance From ITA 3(c)		$34,825
Deduction Under ITA 3(d):		
Net Business Loss		(47,384)
Net Income For Tax Purposes (Division B Income)		Nil

In this Case, Mr. Bowman would have a business loss carry over in the amount of $12,559 ($47,384 - $34,825).

Case 4

The Case 4 solution would be calculated as follows:

Income Under ITA 3(a):		
Interest Income	$ 4,850	
Net Business Income	35,682	$40,532
Income Under ITA 3(b):		
Taxable Capital Gains [(1/2)($8,460)]	$4,230	
Allowable Capital Losses [(1/2)($18,462)]	(9,231)	Nil
Balance From ITA 3(a) And (b)		$40,532
Moving Expenses		(5,643)
Balance From ITA 3(c)		$34,889
Deduction Under ITA 3(d):		
Net Rental Loss		(51,462)
Net Income For Tax Purposes (Division B Income)		Nil

Mr. Bowman would have a rental loss carry over in the amount of $16,573 ($51,462 - $34,889) and unused allowable capital losses in the amount of $5,001 ($9,231 - $4,230).

Chapter Two Test Item File Solutions

TIF Solution Two - 1

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

2. While there are other possibilities, the ones that are mentioned in the text are:

   - Normal withholding is based on rates in a low tax rate province, but the individual resides in a high tax rate province (e.g., the individual works in Alberta, but lives in Saskatchewan).
   - An individual receives large amounts of taxable spousal support payments that are not subject to withholding.

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

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

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

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

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

5. The CRA's instalment reminder results in total instalment payments equal to the net tax owing in the previous taxation year. If the estimated net tax owing for the current year is less, lower instalments could be paid using the estimated current year net tax owing as the base.

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

7. Interest on later instalments is calculated using the highest prescribed rate (the regular rate plus 4 percentage points) applied for the period from the date the instalment is due until the balance due date for the total tax payable.

8. She should file the return on the due date, regardless of whether she has the funds to pay the balance owing. Whether or not she files, she will have to pay interest on the balance owing. However, if she delays filing until early July, she will not only have to pay the non-deductible interest, she will also be subject to an immediate penalty of 5 percent of the balance owing, plus an additional 1 percent per complete month for the period from April 30, for a total penalty of 7 percent.

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

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

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

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

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

    Method 3 The first two instalments can be based on one-twelfth of the taxes payable for the second previous year. The remaining 10 instalments will then be based on the taxes payable for the previous taxation year reduced by the amounts paid in the first two instalments, with this amount divided by 10.

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

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

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

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

12. Corporate tax returns must be filed within six months of the end of the corporation's taxation year. In contrast, the balance due date is either 2 months after the end of the corporation's taxation year (general rule) or 3 months after the end of the corporation's taxation year (qualifying CCPCs). As a consequence, payment is always required prior to the due date for filing the corporate tax return.

13. There are a number of situations that could be cited. The ones listed in the text are as follows:

    - Reassessment can occur at any time if the taxpayer or person filing the return has made any misrepresentation that is attributable to neglect, carelessness or willful default, or has committed any fraud in filing the return or in supplying information under the *Income Tax Act*.
    - Reassessment can occur at any time if the taxpayer has filed a waiver of the normal time limit. A taxpayer can revoke such a waiver at any time.
    - Reassessment can occur outside the normal reassessment period if an individual or testamentary trust has requested a reduction in taxes, interest, or penalties. The ability to use this provision is limited to ten years after the particular year in question.
    - Reassessment can occur beyond the normal reassessment period when reassessment within the normal period affects a balance outside of this period.

- Reassessment can occur outside the normal reassessment period in situations where the taxpayer is claiming certain specified deductions, such as a loss carry back for that year.

14. The general and informal procedures differ as follows:

    - Under the informal procedures, the tax involved must be less than $25,000, or the loss in question is less than $50,000.
    - Under the informal procedures, an individual can represent himself, or be represented by someone other than a lawyer (e.g., an accountant).
    - Under the informal procedures, the taxpayer cannot be assessed court costs.
    - Under the informal procedures, if the taxpayer loses, there is no appeal to a higher court.
    - Informal procedures usually resolve a dispute much more quickly than the general procedures.

15. Tax evasion is described on the CRA web site as follows:

    Tax evasion typically involves deliberately ignoring a specific part of the law. For example, those participating in tax evasion may under-report taxable receipts or claim expenses that are non-deductible or overstated. They might also attempt to evade taxes by wilfully refusing to comply with legislated reporting requirements.

    A less clear description of tax avoidance is as follows:

    When tax planning reduces taxes in a way that is inconsistent with the overall spirit of the law, the arrangements are referred to as **tax avoidance**. The Canada Revenue Agency's interpretation of the term "tax avoidance" includes all unacceptable and abusive tax planning. Aggressive tax planning refers to arrangements that "push the limits" of acceptable tax planning.

TIF Solution Two - 2

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

2. False. There are two filing due dates for individuals. April 30 or, for individuals earning business income, June 15. In addition, deceased taxpayers may have a different filing date.

3. True.

4. True.

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

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

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

8. True.

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

10. True.

11. False. Deliberately ignoring a specific provision in the *Income Tax Act* is tax evasion, not tax avoidance.

12. True.

13. True.

TIF Solution Two - 3

New For 2016/2017

1. C. If an individual has no Taxable Income for the year, they do not have to file an income tax return

2. D. A self employed individual with a net business loss for the year does not have to file an income tax return for the year.

3. B. Charlotte Bronte, who realized capital gains of $3,500 in 2015 and $4,000 in 2016. Her only other income during the years 2014 through 2016 was employment income. The net tax owing on the taxable one-half of these gains would be less than $3,000. A. is not correct as there is a requirement to pay instalments, although the minimum instalment would be nil.

4. B. All corporations must file their income tax returns electronically. If their gross revenues are less than $1,000,000, they can file a paper return.

5. C. Twelve payments of $6,250 per month.

6. B. April 30, 2018.

Retained From Previous Editions

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

8. B. John must file a tax return on or before June 15, 2017.

9. B. April 30, 2017.

10. B. June 15, April 30.

11. E. Nil. The late filing penalty amounts to 5 percent of the tax that was unpaid at the filing due date. Since Ms. Deveco has paid more than her net tax owing by April 30, 2017, there are no penalties or interest.

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

13. D. June 15, 2017.

14. B. June 15, 2017, his regular filing date for his 2016 tax return.

15. C. August 1, 2017.

16. A. April 30, 2017

17. C. $1,875 ($7,500 ÷ 4).

18. B. $3,750 ($15,000 ÷ 4).

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

20. D. If Larry has as much income in 2017 as he had in 2016, he will have to pay instalments during 2017.

21. C. When net tax owing is over $3,000 for the current year and one of the two prior years.

22. A. To pay the amounts provided by the CRA in their instalment reminder on or before the required dates. B is wrong as the estimate for the current year may be too low.

23. A. Dora should pay off her credit card balance before making instalment payments.

24. B. The penalty for a first offence is 5% + 1% per full month late to a maximum of 12 months. Since the return was more than 19 months late, the maximum penalty is 17% of $15,500 = $2,635.

25. C. A taxpayer who has a balance owing files their tax return late, with the payment enclosed.

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

27. D. The return would be due on May 31, 2017, six months after the taxation year end.

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

29. D. Two months after the end of the fiscal year, or three months after the end of the fiscal year if the corporation is a small CCPC.

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

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

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

33. A. Taxable income cannot exceed $500,000 for the corporation and its associated corporations for the current taxation year and the two previous years.

34. C. When a return has been reassessed once, no further reassessments are permitted.

35. B. The change is based on a successful appeal to the courts by another taxpayer.

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

37. C. Her notice of objection must be filed before the later of: 90 days from the date of the notice of assessment (July 18, 2017), and one year from the filing due date for the return (April 30, 2018).

38. D. It must be filed no later than 90 days after the date of the notice of assessment.

39. D. April 30, 2018.

40. D. tax planning.

TIF Solution Two - 4

Exam Exercise Solution Two - 1 (Individual Due Dates)

While Mr. Brown's 2016 tax return does not have to be filed until June 15, 2017, his tax liability must be paid by April 30, 2017 in order to avoid the assessment of interest.

Exam Exercise Solution Two - 2 (Individual Due Dates)

While Ms. Farrel's 2016 tax return does not have to be filed until June 15, 2017, her tax liability must be paid by April 30, 2017 in order to avoid the assessment of interest.

Exam Exercise Solution Two - 3 (Deceased Taxpayer Due Date)

Mr. Klause's 2016 tax return must be filed by the later of six months after the date of his death and his normal filing date. Given that his income is from an unincorporated business, his normal filing date for the 2016 return would be June 15, 2017. However, the later date is September 1, 2017, six months after the date of his death.

Exam Exercise Solution Two - 4 (Deceased Taxpayer Due Date)

Ms. Klump's 2016 tax return must be filed by the later of six months after the date of her death and her normal filing date. Six months after her death would be June 1, 2017. However, because she has income from an incorporated business, her normal filing date would be June 15, 2017. Given this, the later date is June 15, 2017.

Exam Exercise Solution Two - 5 (Individual Instalments)

As the net tax owing for the current year and one of the two preceding years exceeds $3,000, she is required to make instalment payments. The best alternative for instalment payments would be to use the current year estimate. This would result in required instalment payments of $900 ($3,600 ÷ 4) to be paid on March 15, June 15, September 15, and December 15. Note, however, that if the estimated taxes payable are below actual taxes payable for 2016, instalment interest may be charged.

Exam Exercise Solution Two - 6 (Individual Instalments)

The net tax owing amounts can be calculated as follows:

2014 $11,000 ($56,000 - $45,000)
2015 $2,800 ($49,000 - $46,200)
2016 $20,000 ($65,000 - $45,000)

As the net tax owing exceeds $3,000 in the current year and the second preceding year, instalments are required. The Instalment Reminder will have March 15 and June 15 instalments of $2,750 each ($11,000 ÷ 4). There would be no further instalments required for 2016 as his net tax owing for 2015 is only $2,800 and he would already have paid $5,500 [(2)($2,750)].

The best alternative for instalment payments would be to use the prior year option. This would result in required instalment payments of $700 ($2,800 ÷ 4) to be paid on March 15, June 15, September 15, and December 15.

Exam Exercise Solution Two - 7 (Individual Instalments)

The net tax owing amounts can be calculated as follows:

2014 $5,000 ($83,000 - $78,000)
2015 Nil ($76,000 - $77,000). Note this is nil, not a negative amount.
2016 $4,000 ($63,000 - $59,000)

As the net tax owing exceeds $3,000 in the current year and the second preceding year, instalments are required. The three alternatives for calculating instalment payments are as follows:

- Based on the estimate for the current year, the instalments would be $1,000 ($4,000 ÷ 4).
- Based on the estimate for the preceding year, the instalments would be nil.
- Based on the second preceding year, the first two instalments would each be $1,250 ($5,000 ÷ 4). As the net tax owing for the previous year is nil, no further instalments would be required.

The best alternative would be to base the payments on the previous year, resulting in instalments of nil.

Exam Exercise Solution Two - 8 (Penalties And Interest For Individuals)

Given the size of her net tax owing, ITA 163.1 will not be applicable and there will be no penalties for late instalments. However, a penalty of 8 percent of taxes payable will be assessed for filing three complete months late (5 percent, plus 1 percent per month). If, in one of the three preceding taxation years she has also late filed, the penalty could be 16 percent (10 percent, plus 2 percent per month) if the CRA has already sent a request for the return.

Interest will be assessed on the deficient instalments, the balance owing on her filing date, and the penalty assessed for late filing. It will be assessed at the prescribed base rate plus 4 percent for the period May 1 through August 24, 2017.

Exam Exercise Solution Two - 9 (Penalties And Interest For Individuals)

A penalty of 9 percent of Tax Payable will be assessed for filing 4 complete months late (5 percent, plus 1 percent per month). There will be no interest on late instalments because, with the previous year's Tax Payable at nil, the required instalments were nil. This would also mean that the ITA 163.1 penalty could not apply.

Interest at the prescribed base rate plus 4 percent will be assessed on the balance owing on his filing date and the penalty assessed for late filing for the period May 1 through September 12, 2017.

Exam Exercise Solution Two - 10 (Corporate Instalments - Regular And Small CCPC)

Not Small CCPC The first two instalments would be based on the second preceding year and would be $5,958.33 each ($71,500 ÷ 12). The remaining 10 instalments would be based on the preceding year, less the $11,916.66 paid in the first two instalments. The amount would be $8,168.33 [($93,600 - $11,916.66) ÷ 10]. The instalments would be due on the last day of each month in 2016.

Small CCPC In this case, the first instalment would be based on the second preceding year and would be $17,875 ($71,500 ÷ 4). The remaining 3 instalments would be based on the preceding year, less the $17,875 paid for the first instalment. The amount would be $25,241.67 [($93,600 - $17,875) ÷ 3]. The instalments would be due on the last days of March, June, September, and December, 2016.

Note that when the initial instalment(s) are based on the second preceding year, the total amount of instalments will be the same as when all of the instalments are based on the first preceding year. However, using the second preceding year is preferable in that it provides some deferral of taxes.

Exam Exercise Solution Two - 11 (Corporate Instalments - Regular And Small CCPC)

Not Small CCPC The minimum instalments would be based on the estimated taxes payable for 2016. The amount would be $4,358.33 ($52,300 ÷ 12). The instalments would be due on the last day of each month in 2016. Note that, if the estimate for 2016 is too low, interest will be assessed on the deficiency.

Small CCPC In this case, all four instalments would be based on the estimated taxes payable for 2016. The amount would be $13,075 ($52,300 ÷ 4). The instalments would be due on the last days of March, June, September, and December, 2016.

Note that when the initial instalment(s) are based on the second preceding year, the total amount of instalments will be the same as when all of the instalments are based on the first preceding year. However, using the second preceding year is preferable in that it provides some deferral of taxes.

Exam Exercise Solution Two - 12 (Corporate Instalments - Regular And Small CCPC)

Not Small CCPC Minimum instalments would be based on the estimate for the current year. The monthly amount would be $4,683.33 ($56,200 ÷ 12). If the second previous year was used, the first two installments would be lower. However, as the remaining instalments would be based on the previous year's $93,400, the total would be significantly larger. The instalments would be due on the last day of each month during the period October, 2015 through September, 2016. Note that, if the estimate for 2016 is too low, interest will be assessed on the deficiency.

Small CCPC Minimum instalments would be based on the estimate for the current year. The monthly amount would be $14,050 ($56,200 ÷ 4). The instalments would be due on the last day of December, 2015, March, 2016, June, 2016, and September, 2016.

Exam Exercise Solution Two - 13 (Corporate Due Dates - CCPC)

Grange Inc.'s tax return is due six months after its year end, on September 30, 2016. As it is a CCPC that claims the small business deduction, and its Taxable Income for the preceding taxation year did not exceed $500,000, the final tax payment is due three months after the year end. This would be June 30, 2016.

Exam Exercise Solution Two - 14 (Corporate Due Dates)

Lawnco Inc.'s tax return is due six months after its year end, on July 31, 2016. As Lawnco is a public company that is not eligible for the small business deduction, the final tax payment is due two months after the year end, on March 31, 2016.

Exam Exercise Solution Two - 15 (Corporate Due Dates - CCPC)

Breyson's tax return is due six months after its year end of June 30, 2016. This would be December 31, 2016. As it is a CCPC that claims the small business deduction, and its Taxable Income for the preceding taxation year did not exceed $500,000, its final tax payment is due three months after the year end on September 30, 2016.

Exam Exercise Solution Two - 16 (Notice of Objection)

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

- 90 days after the date on the Notice of Reassessment (September 30, 2018); or
- one year after the due date for filing the return that is being reassessed (April 30, 2018).

The later of these two dates is September 30, 2018.

Exam Exercise Solution Two - 17 (Notice of Objection)

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

- 90 days after the date on the Notice of Reassessment (June 6, 2018); or
- one year after the due date for filing the return that is being reassessed (June 15, 2018).

The later of these two dates is June 15, 2018.

TIF Solution Two - 5A

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

A. 9

B. 4

C. 6

D. 3

E. 1

F. 7

G. 2

H. 5

The two unused definitions are as follows:

Assessment = 10

GAAR = 8

TIF Solution Two - 5B

For some terms there is both a 100 percent correct answer and an answer that is close. We have indicated the “close answer” in brackets.

The correct definitions for each of the listed key terms listed below.

A. 12 (not 14)

B. 5 (not 9)

C. 7 (not 2)

D. 4

E. 1

F. 8 (not 10)

G. 3

H. 6

The two unused definitions are as follows:

Assessment = 13

GAAR = 11

TIF Solution Two - 6

Case One

1. The individual's net tax owing in each of the three years is as follows:

   2014 = Nil ($72,300 - $73,700)
   2015 = $6,200 ($89,400 - $83,200)
   2016 = $3,300 ($78,300 - $75,000)

   As the net tax owing exceeds $3,000 in the current year and one of the two preceding years, instalments are required.

2. The three alternatives would be:

   - Quarterly instalments of $825 ($3,300 ÷ 4) based on the current year estimate.
   - Quarterly instalments of $1,550 ($6,200 ÷ 4) based on the first preceding year.
   - Based on the second preceding year, the first two instalments would be nil. The remaining two instalments would be $3,100 each [($6,200 -
   - Nil) ÷ 2] for a total of $6,200.

3. The best alternative to minimize instalments would be four quarterly instalments of $825, for a total of $3,300.

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

Case Two

1. The individual's net tax owing in each of the three years is as follows:

   2014 = $7,200 ($72,300 - $65,100)
   2015 = Nil ($89,400 - $90,100)
   2016 = $6,400 ($78,300 - $71,900)

   As the net tax owing exceeds $3,000 in the current year and one of the two preceding years, instalments are required.

2. The three alternatives would be:

   - Quarterly instalments of $1,600 ($6,400 ÷ 4) based on the current year estimate.
   - Quarterly instalments of nil based on the first preceding year.
   - Two quarterly instalments of $1,800 ($7,200 ÷ 4) based on the second preceding year. No further instalments would be required.

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

Case Three

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is a small CCPC, instalments will be quarterly.

2. The three acceptable alternatives would be as follows:

   - Quarterly instalments of $19,575 ($78,300 ÷ 4) based on the current year estimate.
   - Quarterly instalments of $22,350 ($89,400 ÷ 4) based on the first preceding year.
   - One instalment of $18,075 ($72,300 ÷ 4) based on the second preceding year, followed by three instalments of $23,775 [($89,400 - $18,075) ÷ 3], a total of $89,400.

3. The best alternative would be four instalments of $19,575, for total payments of $78,300.

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

Case Four

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is not a small CCPC, monthly instalments are required.

2. The three acceptable alternatives would be as follows:

   - Monthly instalments of $6,525 ($78,300 ÷ 12) based on the current year estimate.
   - Monthly instalments of $6,208.33 ($74,500 ÷ 12) based on the first preceding year.
   - Two monthly instalments of $6,025 ($72,300 ÷ 12) based on the second preceding year, followed by 10 monthly instalments of $6,245 {[($74,500 - (2)($6,025)] ÷ 10}, a total of $74,500.

3. In terms of minimizing instalment payments, both the second and third alternatives involve paying $74,500, which is less than the payment of $78,300 under the first alternative. While the problem does not ask you to take into consideration deferral, the third alternative would be the best in that the first two payments are lower.

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

TIF Solution Two - 7

Need For Instalments

Instalments are required when an individual's "net tax owing" exceeds $3,000 in the current year and in either of the two preceding years. In somewhat simplified terms, "net tax owing" is defined as the combined federal and provincial taxes payable, less amounts withheld under ITA 153. Mr. Grafton's net tax owing figures are as follows:

2014 = $1,700 ($31,500 - $29,800)
2015 = $8,400 ($14,600 - $6,200)
2016 = $3,100 ($27,400 - $24,300) Estimated

As Mr. Grafton's net tax owing in 2016 (the current year) and his net tax owing in 2015 (one of the two preceding years) is greater than $3,000, he is required to make instalment payments.

Amounts

If Mr. Grafton bases the first two quarterly payments on the 2014 net tax owing, they would only be $425 each ($1,700 ÷ 4). However, the payments for the last two quarters would be $3,775 each {[$8,400 - (2)($425)] ÷ 2}, resulting in total instalment payments of $8,400.

A preferable alternative would be to base the payments on the net tax owing for 2016. These payments would be $775 each ($3,100 ÷ 4), for a total of $3,100.

Payment Dates

The quarterly payments would be due on March 15, June 15, September 15, and December 15.

TIF Solution Two - 8

Case One

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is not a small CCPC, monthly instalments are required.

2. The three acceptable alternatives would be as follows:

   - Monthly instalments of $9,435 ($113,220 ÷ 12) based on the current year estimate.
   - Monthly instalments of $10,185 ($122,220 ÷ 12) based on the first preceding year.
   - Two monthly instalments of $8,640 ($103,680 ÷ 12) based on the second preceding year, followed by 10 monthly instalments of $10,494 {[($122,220 - (2)($8,640)] ÷ 10}, a total of $122,220.

3. The best alternative in terms of minimum instalments would be 12 instalments of $9,435, resulting in a total of $113,220 of instalment payments.

   The instalments would be due on the last day of each month, beginning in January, 2016.

Case Two

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is not a small CCPC, monthly instalments are required.

2. The three acceptable alternatives would be as follows:

   - Monthly instalments of $9,435 ($113,220 ÷ 12) based on the current year estimate.
   - Monthly instalments of $9,210 ($110,520 ÷ 12) based on the first preceding year.
   - Two monthly instalments of $8,640 ($103,680 ÷ 12) based on the second preceding year, followed by 10 monthly instalments of $9,324 {[($110,520 - (2)($8,640)] ÷ 10}, a total of $110,520.

3. The best alternative would be two payments of $8,640, followed by ten payments of $9,324. While the total instalments are the same $110,520 in both the second and third alternatives, the third alternative is preferable because the first two payments are lower. This provides a small amount of tax deferral.

   The instalments would be due on the last day of each month, beginning in January, 2016.

Case Three

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is a small CCPC, instalments will be quarterly.

2. The three acceptable alternatives would be as follows:

   - Quarterly instalments of $28,305 ($113,220 ÷ 4) based on the current year estimate.
   - Quarterly instalments of $30,555 ($122,220 ÷ 4) based on the first preceding year.
   - One instalment of $25,920 ($103,680 ÷ 4) based on the second preceding year, followed by three instalments of $32,100 [($122,220 - $25,920) ÷ 3], a total of $122,220.

3. The best alternative in terms of minimum instalments would be four instalments of $28,305, for total payments of $113,220. The instalments are due on March 31, June 30, September 30, and December 31, 2016.

Case Four

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is a small CCPC, instalments will be quarterly.

2. The three acceptable alternatives would be as follows:
   - Quarterly instalments of $28,305 ($113,220 ÷ 4) based on the current year estimate.
   - Quarterly instalments of $27,630 ($110,520 ÷ 4) based on the first preceding year.
   - One instalment of $25,920 ($103,680 ÷ 4) based on the second preceding year, followed by three instalments of $28,200 [($110,520 - $25,920) ÷ 3], a total of $110,520.

3. The best alternative would be one payment of $25,920, followed by three payments of $28,200. While the total instalments are the same $110,520 in both the second and third alternatives, the third alternative is preferable because the first payment is lower. This provides a small amount of tax deferral.

   The instalments are due on March 31, June 30, September 30, and December 31, 2016.

TIF Solution Two - 9

While there are alternatives in all Cases, the following answers represent the "minimum" instalments, as required in the problem.

Case One

Mr. Shivraj's net tax owing in each of the three years is as follows:

2014 = $2,300 ($13,500 - $11,200)
2015 = $3,300 ($16,200 - $12,900)
2016 = $3,300 ($18,400 - $15,100) Estimated

As his net tax owing is expected to exceed $3,000 in 2016 and was more than $3,000 in 2015, the payment of instalments is required.

Since the net tax owing is the same in the current year and the preceding year, the total instalments will equal $3,300 under any of the alternatives. The best alternative would be to base the first two instalments on 2014. These would be $575 ($2,300 ÷ 4) each and would offer a small amount of deferral over the preceding year or current year alternatives. The remaining two instalments would each be $1,075 {[$3,300 - (2)($575)] ÷ 2} for a total of $3,300.

They would be due on March 15, June 15, September 15, and December 15.

Case Two

Mr. Shivraj's net tax owing in each of the three years is as follows:

2014 = $4,300 ($13,500 - $9,200)
2015 = $5,900 ($16,200 - $10,300)
2016 = $3,500 ($18,400 - $14,900) Estimated

As his net tax owing is expected to exceed $3,000 in 2016 and was more than $3,000 in both the first and second preceding years, the payment of instalments is required.

Using the 2016 net tax owing would result in minimum instalment payments of $875 ($3,500 ÷ 4) for a total of $3,500.

They would be due on March 15, June 15, September 15, and December 15.

Case Three

Mr. Shivraj's net tax owing in each of the three years is as follows:

2014 = $3,400 ($13,500 - $10,100)
2015 = Nil ($16,200 - $16,300) Note that a negative number is not used here.
2016 = $3,700 ($18,400 - $14,700) Estimated

As his net tax owing is expected to exceed $3,000 in 2016 and was more than $3,000 in 2014, the payment of instalments is required.

Using the 2015 net tax owing would result in minimum instalment payments. Based on this year, the required quarterly instalments would be nil.

TIF Solution Two - 10

Case One

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is a small CCPC, instalments will be quarterly.

2. The three acceptable alternatives would be as follows:

   - Quarterly instalments of $23,650 ($94,600 ÷ 4) based on the current year estimate.
   - Quarterly instalments of $25,350 ($101,400 ÷ 4) based on the first preceding year.
   - One instalment of $21,625 ($86,500 ÷ 4) based on the second preceding year, followed by three instalments of $26,591.67 [($101,400 - $21,625 ÷ 3], a total of $101,400.

3. The best alternative in terms of minimum instalments would be four instalments of $23,650, for total payments of $94,600. The instalments are due on March 31, June 30, September 30, and December 31, 2016.

Case Two

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is a small CCPC, instalments will be quarterly.

2. The three acceptable alternatives would be as follows:

   - Quarterly instalments of $23,650 ($94,600 ÷ 4) based on the current year estimate.
   - Quarterly instalments of $23,025 ($92,100 ÷ 4) based on the first preceding year.
   - One instalment of $21,625 ($86,500 ÷ 4) based on the second preceding year, followed by three instalments of $23,491.67 [($92,100 - $21,625) ÷ 3], a total of $92,100.

3. The best alternative would be one payment of $21,625, followed by three payments of $23,491.67. While the total instalments are the same $92,100 in both the second and third alternatives, the third alternative is preferable because the first payment is lower. This provides a small amount of tax deferral.

   The instalments are due on March 31, June 30, September 30, and December 31, 2016.

Case Three

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is not a small CCPC, monthly instalments are required.
2. The three acceptable alternatives would be as follows:

   - Monthly instalments of $7,883.33 ($94,600 ÷ 12) based on the current year estimate.
   - Monthly instalments of $8,450.00 ($101,400 ÷ 12) based on the first preceding year.
   - Two monthly instalments of $7,208.33 ($86,500 ÷ 12) based on the second preceding year, followed by 10 monthly instalments of $8,698.33 {[($101,400 - (2)($7,208.33)] ÷ 10}, a total of $101,400.
3. The best alternative in terms of minimum instalments would be 12 instalments of $7,883.33, resulting in a total of $94,600 of instalment payments.

   The instalments would be due on the last day of each month, beginning in January, 2016.

Case Four

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is not a small CCPC, monthly instalments are required.

2. The three acceptable alternatives would be as follows:

   - Monthly instalments of $7,883.33 ($94,600 ÷ 12) based on the current year estimate.
   - Monthly instalments of $7,675 ($92,100 ÷ 12) based on the first preceding year.
   - Two monthly instalments of $7,208.33 ($86,500 ÷ 12) based on the second preceding year, followed by 10 monthly instalments of $7,768.33 {[($92,100 - (2)($7,208.33)] ÷ 10}, a total of $92,100.

3. The best alternative would be two payments of $7,208.33, followed by ten payments of $7,768.33. While the total instalments are the same $92,100 in both the second and third alternatives, the third alternative is preferable because the first two payments are lower. This provides a small amount of tax deferral.

   The instalments would be due on the last day of each month, beginning in January, 2016.

TIF Solution Two - 11

While there are alternatives in all Cases, the following answers represent the “minimum” instalments, as required in the problem.

In all three Cases, the current year alternative is the best, but you should note that if the estimated net tax owing is lower than the actual net tax owing, she may be charged interest on the insufficient instalments if the interest totals more than $25.

Part A - Case One

Ms. Sloan's net tax owing in each of the three years is as follows:

2014 = $500 ($23,600 - $23,100)
2015 = $4,300 ($25,400 - $21,100)
2016 = $3,900 ($27,200 - $23,300) Estimated

As her net tax owing is expected to exceed $3,000 in 2016 and was more than $3,000 in 2015, the payment of instalments is required.

Under the CRA approach, the first two instalments would be $125 [($500 ÷ 4)] each, for a total of $250. The remaining two instalments would be $2,025 [($4,300 - $250) ÷ 2], for a total of $4,050. This would bring the total instalments for the year to $4,300 ($250 + $4,050). A better solution would be to base the instalments on the estimated 2016 results. Each instalment would be $975 ($3,900 ÷ 4). The resulting total of $3,900 would be less than the $4,300 total under the CRA approach.

Part A - Case Two

Ms. Sloan's net tax owing in each of the three years is as follows:

2014 = Nil ($23,600 - $24,100)
2015 = $6,800 ($25,400 - $18,600)
2016 = $3,500 ($27,200 - $23,700) Estimated

As her net tax owing is expected to exceed $3,000 in 2016 and was more than $3,000 in 2015, the payment of instalments is required.

Under the CRA approach, no payment would be required for the first two instalments. However, the remaining two instalments would be $3,400 each [($6,800 - Nil) ÷ 2], bringing the total for the year to $6,800. A better solution would be to base the instalments on the estimated 2016 results. Each instalment would be $875 ($3,500 ÷ 4). The resulting total of $3,500 would be less than the $6,800 total under the CRA approach.

Part A - Case Three

Ms. Sloan's net tax owing in each of the three years is as follows:

2014 = $4,500 ($23,600 - $19,100)
2015 = $5,200 ($25,400 - $20,200)
2016 = $2,900 ($27,200 - $24,300) Estimated

As her net tax owing is not expected to exceed $3,000 in 2016, the payment of instalments is not required.

Part B

In Case One and Case Two, the required instalments would be due on March 15, June 15, September 15, and December 15.

TIF Solution Two - 12

Case One

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is not a small CCPC, monthly instalments are required.

2. The three acceptable alternatives would be as follows:

   - Monthly instalments of $5,241.67 ($62,900 ÷ 12) based on the current year estimate.
   - Monthly instalments of $5,658.33 ($67,900 ÷ 12) based on the first preceding year.
   - Two monthly instalments of $4,800 ($57,600 ÷ 12) based on the second preceding year, followed by 10 monthly instalments of $5,830 {[($67,900 - (2)($4,800)] ÷ 10}, a total of $67,900.

3. The best alternative in terms of minimum instalments would be 12 instalments of $5,241.67, resulting in a total of $62,900 of instalment payments.

   The instalments would be due on the last day of each month, beginning in January, 2016.

Case Two

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is not a small CCPC, monthly instalments are required.

2. The three acceptable alternatives would be as follows:

   - Monthly instalments of $5,241.67 ($62,900 ÷ 12) based on the current year estimate.
   - Monthly instalments of $5,116.67 ($61,400 ÷ 12) based on the first preceding year.
   - Two monthly instalments of $4,800 ($57,600 ÷ 12) based on the second preceding year, followed by 10 monthly instalments of $5,180 {[($61,400 - (2)($4,800)] ÷ 10}, a total of $61,400.

3. The best alternative would be two payments of $4,800, followed by ten payments of $5,180. While the total instalments are the same $61,400 in both the second and third alternatives, the third alternative is preferable because the first two payments are lower. This provides a small amount of tax deferral.

   The instalments would be due on the last day of each month, beginning in January, 2016.

Case Three

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is a small CCPC, instalments will be quarterly.

2. The three acceptable alternatives would be as follows:

   - Quarterly instalments of $15,725 ($62,900 ÷ 4) based on the current year estimate.
   - Quarterly instalments of $16,975 ($67,900 ÷ 4) based on the first preceding year.
   - One instalment of $14,400 ($57,600 ÷ 4) based on the second preceding year, followed by three instalments of $17,833.33 [($67,900 - $14,400) ÷ 3], a total of $67,900.

3. The best alternative in terms of minimum instalments would be four instalments of $15,725, for total payments of $62,900. The instalments are due on March 31, June 30, September 30, and December 31, 2016.

Case Four

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is a small CCPC, instalments will be quarterly.

2. The three acceptable alternatives would be as follows:
   - Quarterly instalments of $15,725 ($62,900 ÷ 4) based on the current year estimate.
   - Quarterly instalments of $15,350 ($61,400 ÷ 4) based on the first preceding year.
   - One instalment of $14,400 ($57,600 ÷ 4) based on the second preceding year, followed by three instalments of $15,667.67 [($61,400 - $14,400) ÷ 3], a total of $61,400.

3. The best alternative would be one payment of $14,400, followed by three payments of $15,667.67. While the total instalments are the same $61,400 in both the second and third alternatives, the third alternative is preferable because the first payment is lower. This provides a small amount of tax deferral.

   The instalments are due on March 31, June 30, September 30, and December 31, 2016.

Chapter Three Test Item File Solutions

TIF Solution Three - 1

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

2. As noted in your text, the first step in making this distinction is to determine the intent of both parties. Both the worker and the payer must be clear as to whether there is a contract of service (employee/employer) or alternatively, a contract for services (business relationship). In many cases, the intent may be clear. However, the worker and payer must ensure that their intent is reflected in the actual terms and conditions of their relationship. In making this determination, the following factors will be considered by the CRA:

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

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

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

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

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

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

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

   Correspondingly, an employee will have little or no opportunity for profit. While there may be productivity bonuses for exceptional work, such amounts are not generally viewed as profit.

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

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

4. The major items here would be:

   - Using independent contractors eliminates the need for payments for CPP, EI, and payroll taxes (where applicable).
   - Independent contractors generally do not receive fringe benefits.
   - Organizations are not committed to retaining independent contractors beyond the current need for their services.
   - Organizations are, in general, not legally responsible for the work of independent contractors.

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

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

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

   Require Return Of Car During extended periods of time when an employee does not use an employer provided vehicle, the vehicle will be considered available for use unless the employer **REQUIRES** it to be returned to their premises. Given this, the employer should have a policy of requiring vehicles to be returned during periods of non-use by the employee.

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

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

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

Cars Costing More Than $30,000 With the taxable benefit to the employee based on the full cost of the car and any portion of the cost in excess of $30,000 not being deductible to the employer, it is difficult to imagine situations in which it would make economic sense for a profit oriented employer to provide any employee with a luxury car. As the taxable benefit to the employee is based on the actual cost of the car, while the deductible amount is limited to $30,000, a situation is created in which the employee is paying taxes on an amount which can be considerably larger than the amount that is deductible to the employer.

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

8. The formula requires a benefit of 2 percent of the cost of the vehicle per month of use. This benefit continues, without regard to the length of time the car is used by the employee. At this rate, after 50 months, the taxable benefit is equal to the value of the vehicle [(2%)(50) = 100%]. If the vehicle is used for more than 50 months, the amount of the benefit will exceed 100 percent of the cost of the vehicle.

9. A reimbursement is an amount paid to an employee to compensate him for actual costs incurred in performing his employment duties. The amount paid will be exactly equal to the costs incurred. In contrast, an allowance is a payment designed to cover, in a general way, the costs of some specified type of activity (e.g., a per diem allowance to cover food and lodging while traveling).

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

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

11. Depending on the plan, the employer may pay all of the premiums, part of the premiums, or none of the premiums. As long as the plan provides periodic benefits that compensate for lost employment income, the premiums paid by the employer are not considered to be taxable benefits to the employee regardless of the share paid.

    Amounts paid by the employee, again without regard to the share paid, are not deductible to the employee.

    If the employer has made any contribution towards the plan premiums that does not create a taxable benefit, the full amount of any disability benefits received must be included in the income of the employee. This amount can be reduced to the extent of the cumulative amount of premiums paid by the employee prior to the receipt of the benefits, as well as those paid during the year the benefits are received.

12. The factors that would have to be considered are as follows:
    - the employer's rate of return on alternative uses for the funds
    - the employer's tax rate
    - the employee's tax rate
    - the prescribed rate
    - the rate available to the employee on a similar arm's length loan

13. The taxable benefit on non-housing loans is calculated using the prescribed rate that is applicable to each calendar quarter. The amount of the benefit is reduced by any interest paid on the loan by the employee during the year or within 30 days of the end of the year.

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

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

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

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

    1. The salesperson must be required by his employer to pay his own expenses. This must be supported by form T2200 signed by the employer.
    2. The salesperson must be ordinarily required to carry on his duties away from the employer’s place of business.
    3. The salesperson must not receive an expense allowance that is not included in income.
    4. The salesperson must receive at least part of his remuneration in the form of commissions.

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

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

17. All employees who qualify to deduct work space in the home costs can deduct an appropriate portion of:

    - Maintenance or operating costs such as water and electricity
    - Minor repairs

    In those cases where the employee has commission income, he can also deduct an appropriate portion of:

    - Property taxes
    - Insurance

    Note that, under no circumstances, can an employee deduct CCA on the home, or any portion of interest on a mortgage on the home.

TIF Solution Three - 2

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

2. True.

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

4. True.

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

6. True.

7. True.

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

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

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

TIF Solution Three - 3

New For 2016/2017

1. B. How much work is performed at a particular site.

2. C. $1,300 ($400 + $600 + $300)

3. D. If an employee drives an employer provided vehicle for more than 20,004 kilometers of personal use during a year, there will be no reduction of the basic standby charge.

4. C. Travel allowances provided by an employer are never included in an employee's income. If an allowance involved an unreasonable amount (i.e., amounts significantly in excess of actual costs), some part of the allowance might be included in the employee's income.

5. B. If the proceeds from the loan are invested in income producing assets, the interest benefit on the loan will be deductible in determining the employee's Net Income For Tax Purposes.

6. B. If shares in a Canadian controlled private corporation are acquired through the exercise of stock options, there will be a deduction equal to one-half of the employment income inclusion, provided the shares were held for at least two years.

7. A. In order for an employee to deduct work space in the home costs it must be the place where that individual principally carries on his employment duties.

Retained From Previous Editions

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

9. C intent, control test, ownership of tools test, opportunity for profit

10. A. Reimbursement of moving expenses.

11. B. Low rent housing.

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

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

14. A. In B, dental plan payments are not a taxable benefit. In C, subsidized meals in employer's facilities do not create a taxable benefit. In D, dental insurance is not a taxable benefit.

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

16. C. Employer reimbursement for the cost of tools required to perform work.

17. B. The Christmas gift is a near-cash gift.

18. H. $3,240.

Standby charge = [(12)(2%)($20,000)(9,000/20,004)] = $2,160
Operating costs - Lesser Of:
- [(9,000)($0.26)] = $2,340
- [(1/2)($2,160)] = $1,080

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

19. C. $1,800.

Standby charge = [(2/3)(12)($500)(11/12)(6,000/18,337)] = $1,200
Operating costs - Lesser Of:
- [(6,000)($0.26)] = $1,560
- [(1/2)($1,200)] = $600

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

20. J. $3,959.

Standby charge = [(10)(2%)($20,000)(11,000/16,670)] = $2,639
Operating costs - Lesser Of:
- [(11,000)($0.26)] = $2,860
- [(1/2)($2,639]) = $1,320

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

21. A. $1,150.
Standby charge = [(2/3)(12)($500)(11/12)(7,500/18,337)] = $1,500
Operating costs - Lesser Of:
- [(7,500)($0.26)] = $1,950
- [(1/2)($1,500)] = $750

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

22. C. The minimum taxable benefit that Mr. Brown must include in his employment income for the use of this vehicle in 2016 is $3,401 [(2%)(12)($31,500)(9,000/20,004)], plus $1,701 [(1/2)($3,401)], a total of $5,102.

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

24. C. Standby charge (employment related portion). Standby charge only applies when an employee uses the employer's automobile for personal use. It is an employment income inclusion (not a deduction).

25. B. $6,500 allowance for business use of employee's automobile (10,000 km x $0.65). "Reasonable allowance" is limited to $5,100 [(5,000 km x $0.54) + (5,000 km x $0.48)]

26. A. Housing loss reimbursement of $20,000. $2,500 of the housing loss reimbursement would be a taxable benefit [$20,000 – 15,000) x 50%]

27. C. Reasonable vehicle allowances are not included in income.

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

29. C. $800 Tax cost of benefit of $300 [($50,000)(3% - 1%)(30%)] + interest paid of $500 [($50,000)(1%)] = $800

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

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

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

32. D.

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

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

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

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

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

36. D. Increase in Net Income for Tax Purposes of $20,000; increase in Taxable Income of $10,000. The exercise of options results in an increase in Net Employment Income of $20,000 [5,000 shares x ($79 - $75)], less the Division C deduction of $10,000 ($20,000 x 50%).

37. A. Increase in Net Income for Tax Purposes of $15,000; increase in Taxable Income of $15,000. [5,000 shares x ($85 - $79)] = $30,000 x 50% = $15,000

38. A. 100 x ($42 - $30) = $1,200 increase

39. C. $3,870 [($18,000 + $850) x 20%] + 100 = $3,870

40. D. $1,475 [($900 + 5,000) x 25%]

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

42. D. Must receive all remuneration in commissions.

TIF Solution Three - 4

Exam Exercise Solution Three - 1 (Bonus)

The bonus will be taxed in Ms. Connely's hands in the year of receipt. This means that it will be included in her 2017 tax return. With respect to Connely Ltd., the bonus is not payable until more than 180 days after the fiscal year end. As a consequence, Connely Ltd. will not be able to deduct the bonus in the year ending August 31, 2016. It will be deducted in the year ending August 31, 2017.

Exam Exercise Solution Three - 2 (Bonus)

The bonus will be taxed in Mr. Gable's hands in the year of receipt. This will be the taxation year ending December 31, 2017. As it is paid within 180 days of Brock's year end, the Company will be able to deduct the bonus in the taxation year which ends on September 30, 2016. Note that the limit is 180 days from the fiscal year end, not the date on which the bonus was declared.

Exam Exercise Solution Three - 3 (GST On Taxable Benefits)

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

Exam Exercise Solution Three - 4 (Taxable Benefits - Employer Owned Automobile)

Rounded to the nearest whole number, 268 days results in 9 months of availability. Further, Ms. Nestor's employment use is over 50 percent, entitling her to a reduction in the full standby charge. Although she can use the alternative one-half of the standby charge calculation of the operating cost benefit, she would not do so as it results in a higher benefit. Given these factors, the taxable benefit would be calculated as follows:

Standby Charge [(2%)(9)($54,000 + $7,020)(5,000/15,003*)]	$3,660
Operating Cost Benefit - Lesser Of:	
• [($0.26)(5,000)] = $1,300	
• [(1/2)($3,660)] = $1,830	1,300
Total Benefit	$4,960

*[(9)(1,667)]

Exam Exercise Solution Three - 5 (Taxable Benefits - Employer Owned Automobile)

As Mr. Rhodes' employment related use is less than 50 percent of total usage, he must use the full standby charge. In addition, he cannot use the alternative one-half of the standby charge calculation of the operating cost benefit. Given this, the taxable benefit would be calculated as follows:

Standby Charge [(2%)(8)($63,000 + $3,150)]	$10,584
Operating Cost Benefit [($0.26)(53,000 - 22,000)]	8,060
Total Benefit	$18,644

Exam Exercise Solution Three - 6
(Taxable Benefits - Employer Leased Automobile)

Rounded to the nearest whole number, 310 days results in 10 months of availability. As Mr. Warren's employment related use is more than 50 percent, he is eligible for a reduction in the full standby charge. He is also eligible for the alternative one-half of the standby charge calculation of the operating cost benefit. Given these factors, the taxable benefit would be calculated as follows:

Standby Charge [(2/3)($791)(10)(16,670* ÷ 16,670*)]	$5,273
Operating Cost Benefit - Lesser Of:	
• [($0.26)(18,000)] = $4,680	
• [(1/2)($5,273)] = $2,637	2,637
Total Benefit	$7,910

*[(10)(1,667)] - the numerator cannot exceed the denominator

Exam Exercise Solution Three - 7
(Taxable Benefits - Employer Leased Automobile)

As Ms. Wexler's employment related usage is more than 50 percent, she is eligible for a reduction in the basic standby charge. She is also eligible for the alternative one-half of the standby charge calculation of the operating cost benefit. Given these factors, the taxable benefit would be calculated as follows:

Standby Charge [(2/3)($728 - $50)(10)(16,670* ÷ 16,670*)]	$4,520
Operating Cost Benefit - Lesser Of:	
• [($0.26)(23,000)] = $5,980	
• [(1/2)($4,520)] = $2,260	2,260
Total Benefit	$6,780

*[(10)(1,667)] - the numerator cannot exceed the denominator

Exam Exercise Solution Three - 8 (Deductible Automobile Costs)

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

Exam Exercise Solution Three - 9 (Deductible Automobile Costs)

As the $6,500 allowance is not based on kilometers driven, it must be included in her income. As the allowance is included in income, she can deduct a proportionate share of her automobile costs. This amount would $5,345 [($12,472)(18,000 ÷ 42,000)]. Her net inclusion will be $1,155 ($6,500 - $5,345).

Exam Exercise Solution Three - 10 (Disability Insurance Benefits)

As her employer contributes to the plan, and the contributions do not create a taxable benefit, the $6,940 in benefits received during the year will be included in her employment income. This will be reduced by the $574 ($324 + $250) in non-deductible contributions that she made during 2015 and 2016, leaving a net inclusion of $6,366 ($6,940 - $574).

Exam Exercise Solution Three - 11 (Disability Insurance Benefits)

Because his employer contributes to the group disability plan, and the contributions do not create a taxable benefit, the $24,000 in benefits that he receives during 2016 will be included in his income. However, this amount will be offset by the $16,000 of contributions that he made in previous years, leaving a net inclusion of $8,000 ($24,000 - $16,000).

Exam Exercise Solution Three - 12 (Employee Housing Loan Benefits)

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

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

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

Exam Exercise Solution Three - 13 (Employee Housing Loan Benefits)

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

The Lesser Of:	
• [($210,000)(4%)(2/12) + ($210,000)(3%)(1/4) + ($210,000)(2%)(1/4)] = $4,025	
• [($210,000)(4%)(8/12)] = $5,600	$4,025
Interest Payments	Nil
Net Benefit	$4,025

Exam Exercise Solution Three - 14 (Tax Planning - Loan Benefits)

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

Required Salary [$12,000 ÷ (1 - 0.44)]	$21,429
Corporate Tax Savings From Deducting Salary [($21,429)(28%)]	(6,000)
Employer's After Tax Cash Flow - Additional Salary	$15,429

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

Required Salary [$3,168 ÷ (1 - 0.44)]	$ 5,657
Corporate Tax Savings From Deducting Salary [($5,657)(28%)]	(1,584)
After Tax Cost Of Salary	$ 4,073
Employer's Lost Earnings [(8.2%)(1 - 0.28)($240,000)]	14,170
Employer's After Tax Cash Flow - Loan	$18,243

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

Exam Exercise Solution Three - 15 (Tax Planning - Loan Benefits)

In the absence of the interest free loan, John would have to borrow $350,000 at 4.5 percent, resulting in an annual interest cost of $15,750 [(4.5%)($350,000)]. In order to pay this after tax amount, John would need additional salary of $29,167 [($15,750 ÷ (1 - 0.46)]. The after tax cash outflow of providing this salary is calculated as follows:

Additional Salary [($15,750 ÷ (1 - 0.46)]	$29,167
Corporate Tax Savings [($29,167)(26%)]	(7,583)
Employer's After Tax Cash Flow - Additional Salary	$21,584

If the loan is provided, John will have a taxable benefit of $7,000 [($350,000)(2%)], resulting in Tax Payable of $3,220 [($7,000)(46%)]. In order to pay these taxes, John will need additional salary of $5,963 [$3,220 ÷ (1 - 0.46)]. For Stern, the after tax cash outflows associated with this additional salary and the loan would be calculated as follows:

Additional Salary [$3,220 ÷ (1 - 0.46)]	$ 5,963
Corporate Tax Savings [($5,963)(26%)]	(1,550)
After Tax Cost Of Salary	$ 4,413
Employer's Lost Earnings [(7%)(1 - 0.26)($350,000)]	18,130
Employer's After Tax Cash Flow - Loan	$22,543

Based on these results, the payment of additional salary appears to be the better alternative.

Exam Exercise Solution Three - 16 (Stock Options - Public Company)

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

Exam Exercise Solution Three - 17 (Stock Options - CCPC)

For options to buy shares of a Canadian controlled private corporation, no employment income benefit is included until the shares are sold. As a result, the exercise of the stock options does not affect her employment income for 2016.

Exam Exercise Solution Three - 18 (Stock Options - Public Company)

The increase in Net Income For Tax Purposes and Taxable Income resulting from the exercise of the options in 2015 would be calculated as follows:

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

When the shares are sold in 2016, the results will be as follows:

Proceeds Of Disposition [(4,000)($97)]	$388,000
Adjusted Cost Base [(4,000)($82)]	(328,000)
Capital Gain	$ 60,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 30,000

This $30,000 taxable capital gain will be both the increase in Net Income For Tax Purposes and the increase in Taxable Income.

Exam Exercise Solution Three - 19 (Stock Options - CCPC)

As Mr. Savage's employer is a Canadian controlled private corporation, the exercise of the options has no effect on his Taxable Income in 2015.

When the shares are sold in 2016, the total increase in Net Income For Tax Purposes and Taxable Income is calculated as follows:

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

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

Exam Exercise Solution Three - 20 (Stock Options - Public Company)

The effect of these transactions would be calculated as follows:

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

Exam Exercise Solution Three - 21 (Stock Options - Public Company)

The granting of the options in 2014 does not affect either Net Income For Tax Purposes or Taxable Income.

As a public company is involved, the exercise of the options in 2015 will have the following tax consequences:

Fair Market Value At Exercise [(2,200)($15)]	$33,000
Cost Of Shares [(2,200)($10.50)]	(23,100)
Employment Income Inclusion (Increase In **Net Income For Tax Purposes**)	$ 9,900
Deduction Under ITA 110(1)(d) [(1/2)($9,900)]	(4,950)
Increase In **Taxable Income**	$ 4,950

When the shares are sold in 2016, the tax consequences are as follows:

Proceeds Of Disposition [(1,000)($13)]	$13,000
Adjusted Cost Base [(1,000)($15)]	(15,000)
Capital Loss	($ 2,000)
Inclusion Rate	1/2
Allowable Capital Loss	($ 1,000)

This loss can only be deducted in the determination of Net Income For Tax Purposes to the extent that Ms. Smithers has taxable capital gains during 2016.

Note to Instructor: Depending on what has been covered in your course, students may or may not be expected to comment on the ability to carry the capital loss back or forward as follows:

If she has taxable capital gains in the previous 3 years or any year in the future, the loss could be carried back or carried forward and deducted in the determination of Taxable Income.

Exam Exercise Solution Three - 22 (Stock Options - CCPC)

The granting of the options in 2014 does not affect either Net Income For Tax Purposes or Taxable Income.

As a CCPC is involved, the exercise of the options does not affect either Net Income For Tax Purposes or Taxable Income. However, the employment income inclusion for all 625 shares is measured in this year (see 2016 results)

When 125 of the 625 shares are sold in 2016, the tax consequences are as follows:

Deferred Employment Income:	
Fair Market Value At Exercise [(125)($95)]	$11,875
Cost Of Shares [(125)($92)]	(11,500)
Employment Income Inclusion (Increase In **Net Income For Tax Purposes**)	$ 375
Deduction Under ITA 110(1)(d) [(1/2)($375)]	(188)
Increase In **Taxable Income**	$ 187

There is also an allowable capital loss, calculated as follows:

Proceeds Of Disposition [(125)($85)]	$10,625
Adjusted Cost Base [(125)($95)]	(11,875)
Capital Loss	($ 1,250)
Inclusion Rate	1/2
Allowable Capital Loss	($ 625)

This loss can only be deducted in the determination of Net Income For Tax Purposes to the extent that Mr. Fallow has taxable capital gains during 2016.

Note to Instructor: Depending on what has been covered in your course, students may or may not be expected to comment on the ability to carry the capital loss back or forward as follows:

If he has taxable capital gains in the previous 3 years or any year in the future, the loss could be carried back or carried forward and deducted in the determination of Taxable Income.

Exam Exercise Solution Three - 23 (Commission Salesperson Expenses)

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

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

Exam Exercise Solution Three - 24 (Commission Salesperson Expenses)

Mr. Ho's total potential deductions are $31,500 [$12,200 + (1/2)($6,400) + $16,100]. However, this total exceeds his commission income and cannot be deducted under ITA 8(1)(f). While he cannot deduct the advertising or entertainment under ITA 8(1)(h), the travel costs can be deducted without limit. As these costs exceed Mr. Ho's commission income, his maximum deduction is the $16,100 in travel costs that can be deducted under ITA 8(1)(h).

Exam Exercise Solution Three - 25 (Employment Income Expenses)

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

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

Exam Exercise Solution Three - 26 (Employment Income Expenses)

As Ms. Ekart receives some of her employment income in the form of commissions, all of the $22,425 in listed expenses is potentially deductible under ITA 8(1)(f) (travel, promotion, and entertainment) and 8(1)(j) (CCA and interest on car). However, under ITA 8(1)(f), all of the expenses other than the CCA and interest on the car are limited to her commission income of $8,400. This would result in a maximum deduction under ITA 8(1)(f) of $12,325 ($8,400 + $2,850 + $1,075).

Alternatively, under ITA 8(1)(h) and ITA 8(1)(h.1), she can deduct the traveling expenses, but not the promotion, advertising and entertainment. However, when the traveling expenses are added to the car costs that are deductible under ITA 8(1)(j), her total deduction would be $14,225 ($10,300 + $2,850 + $1,075). Using this would produce a minimum net employment income calculated as follows:

Salary	$85,000
Commissions	8,400
Deductible Expenses ($10,300 + $2,850 + $1,075)	(14,225)
Net Employment Income	$79,175

TIF Solution Three - 5A

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

A. 9

B. 5

C. 1

D. 6

E. 7

F. 3

G. 8

H. 10

The two unused definitions are as follows:

Standby Charge = 2

Taxable Allowance = 4

TIF Solution Three - 5B

For some terms there is both a 100 percent correct answer and an answer that is close. We have indicated the "close answer" in brackets.

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

A. 11

B. 7

C. 1

D. 8

E. 9 (not 12)

F. 5 (not 14)

G. 10 (not 3)

H. 13 (not 4)

The two unused definitions are as follows:

Standby Charge = 2

Taxable Allowance = 6

TIF Solution Three - 6

The required information for the four Cases included in this problem is as shown in the following table:

	Deduction Lange Enterprises Inc. Year Ending September 30	Inclusion Carl Lange Calendar Year
Case A	2016	2016
Case B	2016	2017
Case C	2017	2017
Case D	2016	2016

In Case A, the bonus is deducted when accrued because it is paid within 180 days of Lange Enterprises' 2016 year end. It is taxed when received.

In Case B, the bonus is deducted when accrued because it is paid within 180 days of Lange Enterprises' 2016 year end. It is taxed when received.

In Case C, the bonus is not paid within 180 days of Lange Enterprises' year end. As a consequence, it cannot be deducted until the year ending September 30, 2017. However, as it is paid within 3 years of Lange Enterprises' 2016 year end it is not a salary deferral arrangement. This means it does not have to be included in Mr. Lange's Taxable Income until 2017.

In Case D, the bonus is not paid until more than 3 years after the end of the calendar year in which Mr. Lange rendered the services. This makes it a salary deferral arrangement, resulting in Mr. Lange having to include it in his 2016 Taxable Income. Lange Enterprises will deduct the bonus in the fiscal year ending September 30, 2016.

TIF Solution Three - 7

Option 1 - Employer Continues To Provide Automobile

If the employer continues to provide the car, Jason's only cash outflow will be the taxes assessed on the taxable benefit that results from his having the car available. This outflow under the two options would be calculated as follows:

	Case A $40,000 Cost	Case B $75,000 Cost
Standby Charge		
[(2%)($40,000)(12)]	$ 9,600	
[(2%)($75,000)(12)]		$18,000
Operating Cost Benefit [(50,000 Kilometers)($0.26)]	13,000	13,000
Total Annual Benefit	$22,600	$31,000
Number Of Years	2	2
Total Benefit	$4,5200	$62,000
John's Marginal Tax Rate	46%	46%
Total Taxes On Taxable Benefit (Cash Outflow)	$20,792	$28,520

Note that, because Jason's use of the car is not primarily (more than 50 percent) for employment purposes, he cannot use the alternative one-half of standby charge calculation of the operating cost benefit.

Option 2 - Jason Purchases The Automobile

If Jason purchases the car and pays his own operating costs, the total cash outflow under both cases would be calculated as follows:

Purchase Price	$30,000
Estimated Resale Value	(17,000)
Operating Costs [(2)(50,000 Kilometers)($0.20)]	20,000
Total Cash Outflow	$33,000

Conclusion - Case A ($40,000 Cost)

On the basis of undiscounted cash flows, the best alternative would be to have Jason's employer continue to provide him with the car. If the cash flows were discounted, the results would be even more favourable for this alternative.

Conclusion - Case B ($75,000 Cost)

Despite the original cost of the car being $75,000, on the basis of undiscounted cash flows, the best alternative would be to have Jason's employer continue to provide him with the car.

Although the requirements of the problem ask that only the cash flows be considered, we would note that the alternative of purchasing the car carries more uncertainty. Both the resale value and the actual operating costs are estimates. If there was a large variation from the estimate for either or both of these amounts, it could substantially affect the total cash outflow of the purchase alternative.

TIF Solution Three - 8

Mr. Joseph Martin The taxable benefit to be allocated to the president of the Company would be calculated as follows:

Standby Charge [(2/3)(7)($2,100)]	$ 9,800
Operating Cost Benefit [(23,000)($0.26)]	5,980
Total Benefit	$15,780

As less than 50 percent of Mr. Martin's kilometers were employment related, he cannot reduce the standby charge or use the alternative calculation of the operating cost benefit, based on one-half of the standby charge, even if it was more advantageous.

Mrs. Grace Martin The taxable benefit to be allocated to the marketing vice president would be calculated as follows:

Standby Charge [(2%)($78,000)(12)(2,000/20,004*)]	$1,872
Operating Cost Benefit - Lesser Of:	
• [(2,000)($0.26)] = $520	
• [(1/2)($1,872)] = $936	520
Total Benefit	$2,392

*[(12)(1,667)]

As more than 50 percent of Mrs. Martin's driving was employment related, there is a reduction in the standby charge to reflect her limited personal use of the vehicle. While Mrs. Martin would qualify for the alternative calculation of the operating cost benefit, it would produce a larger taxable benefit in this situation.

Mr. William Martin The taxable benefit to be allocated to the vice president of finance would be calculated as follows:

Standby Charge [(2/3)(12)($600)]	$ 4,800
Operating Cost Benefit [(32,000)($0.26)]	8,320
Reimbursement [(12)($300)]	(3,600)
Total Benefit	$ 9,520

As less than 50 percent of the kilometers are employment related, there is no reduction in the standby charge. In addition, the alternative calculation of the operating cost benefit cannot be used.

Mrs. Sharon Martin-Jones The taxable benefit that would be allocated to the industrial relations vice president would be calculated as follows:

Standby Charge [(2%)($39,000)(9)(9,500/15,003*)]	$4,445
Operating Cost Benefit - Lesser Of:	
• [(9,500)($0.26)] = $2,470	
• [(1/2)($4,445)] = $2,223	2,223
Total Benefit	$6,668

*[(9)(1,667)]

As more than 50 percent of the use was employment related, there is a reduction in the standby charge. As the car was driven more than 50 percent for employment related purposes, Mrs. Martin-Jones can calculate the operating cost benefit as one-half of the standby charge which results in a lower benefit.

TIF Solution Three - 9

Case A

In this Case, the taxable benefit would be calculated as follows:

Standby Charge [(2%)($42,000)(11)(4,000/18,337*)]	$2,016
Operating Cost Benefit - Lesser Of:	
• [(4,000)($0.26)] = $1,040	
• [(1/2)($2,016)] = $1,008	1,008
Total Benefit	$3,024

*[(11)(1,667)]

As Ms. Smith's usage is more than 50 percent employment related, she can use the reduced standby charge calculation. In addition, she can use one-half the standby charge as her operating cost benefit.

Case B

In this Case, the taxable benefit would be calculated as follows:

Standby Charge [(2%)($42,000)(10)(16,670*/16,670*)]	$ 8,400
Operating Cost Benefit - Lesser Of:	
• [(23,000)($0.26)] = $5,980	
• [(1/2)($8,400)] = $4,200	4,200
Total Benefit	$12,600

*[(10)(1,667)]

As Ms. Smith's usage is more than 50 percent employment related, she can use the reduced standby charge calculation. In addition, she can use one-half the standby charge as her operating cost benefit.

Case C

In this Case, the taxable benefit would be calculated as follows:

Standby Charge [(2%)($42,000)(8)]	$ 6,720
Operating Cost Benefit [(44,000)($0.26)]	11,440
Total Benefit	$18,160

As Ms. Smith's employment usage was less than 50 percent, there is no reduction in the basic standby charge. This also means that Ms. Smith cannot elect to use the alterative calculation of the operating costs benefit as one-half of the standby charge.

TIF Solution Three - 10

Approach

The appropriate comparison in evaluating the interest free loan arrangement would be to determine the cost to the Company of providing the loan, and then to compare this amount with the cost of providing an equivalent benefit in the form of straight salary. The following analysis calculates the Company's lowest cost route to providing Mr. Cheng with the financing required, assuming he is not a shareholder.

Cost Of Providing For Interest Payments On Commercial Loan

Mr. Cheng can borrow on a loan at a rate of interest of 4 percent. This means that the annual interest payments on $250,000 would amount to $10,000. Because the interest on the loan can be deducted, there would be no tax consequences associated with receiving this amount of additional salary. Given this, additional salary of $10,000 will allow him to carry the loan.

The cost of the additional salary to the company would be calculated as follows:

Gross Salary Increase [$5,600 ÷ (1 - .44)]	$10,000
Reduction In Corporate Taxes (At 32 Percent)	(3,200)
Net Cost To Company - Additional Salary	$ 6,800

Cost Of Providing Interest Free Loan

Mr. Cheng would be assessed a taxable benefit on the loan of $7,500 [(3%)($250,000)] for the first year. However, under ITA 80.5, this would be deemed interest paid. As he is using the funds provided to produce income, the full amount would be deductible, resulting in no net change in taxes.

Given this, the analysis of this alternative only requires looking at the cost of the loan to the company:

Lost Earnings On Funds Loaned [(8%)($250,000)]	20,000
Corporate Taxes On Imputed Earnings (At 32 Percent)	(6,400)
Net Cost To Company - Loan	$13,600

Conclusion

On the basis of the preceding analysis, it can be concluded that the Company should provide an additional $10,000 in salary rather than providing Mr. Cheng with an interest free loan of $250,000. This alternative results in a net cost to the Company which is $6,800 ($13,600 - $6,800) lower.

TIF Solution Three - 11

Part A

Mr. Lee would be assessed a taxable benefit on the loan of $10,000 [(2%)($500,000)] for the current year. However, under ITA 80.5, this would be deemed interest paid. As he is using the funds provided to produce income, the full amount would be deductible, resulting in no net change in his taxes.

The cost of the loan to the company for the first year would be calculated as follows:

Lost Earnings On Funds Loaned [(9%)($500,000)]	$45,000
Corporate Taxes On Imputed Earnings (At 27 Percent)	(12,150)
Net Cost To Company - Loan	$32,850

This will result in Mr. Lee having the use of $500,000 at no tax cost to himself and an annual cost of $32,850 to the Company.

Part B

If instead of giving Mr. Lee the $500,000, the Company pays him the potentially lost annual earnings of $45,000, the after tax cost to the Company will be the same, as shown in the following calculation:

Additional Salary	$45,000
Savings In Corporate Taxes (At 27 Percent)	(12,150)
Net Cost To Company - Additional Salary	$32,850

Part C

Mr. Lee can borrow on a loan at a rate of interest of 6 percent. This means that the annual interest payments on $500,000 would amount to $30,000 and would be deductible.

If he receives the additional salary, his after tax income would be as follows:

Additional Salary	$45,000
Deductible Interest On Investment Loan	(30,000)
Increase In Net Income For Tax Purposes	$15,000
Tax Payable (At 46 Percent)	(6,900)
Net Increase In Cash	$ 8,100

Mr. Lee should accept the additional salary of $45,000 per year as it results in an annual cash increase of $8,100.

TIF Solution Three - 12

Part A

There would be no tax effects resulting from the granting of the options in 2014.

Since the option price was below the fair market value at the time the shares were issued, there is no deduction available under ITA 110(1)(d) in the calculation of Taxable Income. As Patricia's employer is a public company, the exercise of the options in 2015 will result in the following addition to Net Income For Tax Purposes and Taxable Income:

Fair Market Value At Exercise [(1,500)($50)]	$75,000
Option Price [(1,500)($45)]	(67,500)
Employment Income (Increase In **Net** And **Taxable Income**	$ 7,500

In 2016, when the shares are sold, there is the following addition to **Net Income For Tax Purposes** and **Taxable Income**:

Proceeds Of Disposition [(1,500)($55)]	$82,500
Adjusted Cost Base [(1,500)($50)]	(75,000)
Capital Gain	$ 7,500
Inclusion Rate	1/2
Taxable Capital Gain	$ 3,750

Part B

There would be no tax effects resulting from the granting of the options in 2014.

If the 2014 trading value for the shares had been $44, the option price would have been above fair market value and the ITA 110(1)(d) deduction would be available. On this basis, the 2015 results would be as follows:

Fair Market Value At Exercise [(1,500)($50)]	$75,000
Option Price [(1,500)($45)]	(67,500)
Employment Income	
Increase In **Net Income For Tax Purposes**	$ 7,500
ITA 110(1)(d) Deduction [(1/2)($7,500)]	(3,750)
Increase In **Taxable Income**	$ 3,750

The results for 2016 would be unchanged from Part A.

Part C

If Patricia's employer had been a Canadian controlled private company, there would be no tax effects in either 2014 or 2015.

There is no deduction available under either ITA 110(1)(d) or ITA 110(1)(d.1) when the shares are sold. The option price was below the fair market value when the options were issued. Further, Patricia did not hold the shares for the two years required for the ITA 110(1)(d.1) deduction. When the shares are sold in 2016, there is the following addition to Net Income For Tax Purposes and Taxable Income:

Fair Market Value At Exercise [(1,500)($50)]	$75,000
Option Price [(1,500)($45)]	(67,500)
Taxable Capital Gain [(1/2)(1,500)($55 - $50)]	3,750
Increase In **Net Income For Tax Purposes** And **Taxable Income**	$11,250

TIF Solution Three - 13

Case A

The required information under the assumption that Lastech Inc. is a Canadian public company is as follows:

- Year of granting - No tax effect.
- Year of exercise - The results for this year would be as follows:

Fair Market Value Of Acquired Shares [($25)(1,500)]	$37,500
Cost Of Acquired Shares [($23)(1,500)]	(34,500)
Employment Income And Increase In **Net Income For Tax Purposes**	$3,000
Deduction Under ITA 110(1)(d) [(1/2)($3,000)]	(1,500)
Increase In **Taxable Income**	$1,500

As the option price was greater than the fair market value of the shares at the time the options were issued, the ITA 110(1)(d) deduction can be taken.

- Year of sale - The tax effects would be as follows:

Proceeds Of Disposition [(1,500)($28)]	$42,000
Adjusted Cost Base [(1,500)($25)]	(37,500)
Capital Gain	$ 4,500
Inclusion Rate	1/2
Taxable Capital Gain	$ 2,250

This $2,250 would be both the increase in **Net Income For Tax Purposes** and the increase in **Taxable Income** for the year.

Case B

The required information under the assumption that Lastech Inc. is a Canadian public company is as follows:

- Year of granting - No tax effect.
- Year of exercise - As the option price was less than the fair market value of the shares at the time the options were issued, the ITA 110(1)(d) deduction from Taxable Income is not available. The tax effects would be as follows:

Fair Market Value Of Acquired Shares [($25)(1,500)]	$37,500
Cost Of Acquired Shares [($23)(1,500)]	(34,500)
Employment Income And Increase In **Net Income For Tax Purposes**	$ 3,000
Deduction Under ITA 110(1)(d)	Nil
Increase In Net Income And **Taxable Income**	$ 3,000

- Year of sale - The tax effects would be as follows:

Proceeds Of Disposition [(1,500)($28)]	$42,000
Adjusted Cost Base [(1,500)($25)]	(37,500)
Capital Gain	$ 4,500
Inclusion Rate	1/2
Taxable Capital Gain	$ 2,250

This $2,250 would be both the increase in **Net Income For Tax Purposes** and the increase in **Taxable Income** for the year.

Case C

The required information under the assumption that Lastech Inc. is a Canadian controlled private corporation is as follows:

- Year of granting - No tax effect.
- Year of exercise - No tax effect.
- Year of sale - The tax effects would be as follows:

Fair Market Value Of Acquired Shares [($25)(1,500)]	$37,500
Cost Of Acquired Shares [($23)(1,500)]	(34,500)
Employment Income	$ 3,000
Taxable Capital Gain [(1,500)($28 - $25)(1/2)]	2,250
Increase In **Net Income For Tax Purposes**	$ 5,250
Deduction Under ITA 110(1)(d) [(1/2)($3,000)]	(1,500)
Increase In **Taxable Income**	$ 3,750

Case D

The required information under the assumption that Lastech Inc. is a Canadian controlled private corporation is as follows:

- Year of granting and exercise - No tax effect.
- Year of sale - As the option price was less than the fair market value of the shares at the time the options were granted, no deduction is available under ITA 110(1)(d). However, Ms. Black held the shares for more than two years after their acquisition and, as a consequence, she can claim a deduction against employment income under ITA 110(1)(d.1). The tax effects would be as follows:

Fair Market Value Of Acquired Shares [($25)(1,500)]	$37,500
Cost Of Acquired Shares [($23)(1,500)]	(34,500)
Employment Income	$ 3,000
Taxable Capital Gain [(1,500)($28 - $25)(1/2)]	2,250
Increase In **Net Income For Tax Purposes**	$5,250
Deduction Under ITA 110(1)(d)	Nil
Deduction Under ITA 110(1)(d.1) [(1/2)($3,000)]	(1,500)
Increase In **Taxable Income**	$3,750

TIF Solution Three - 14

For an employee who earns commissions, motor vehicle costs (other than CCA and financing costs) and other travel costs can be deducted under either ITA 8(1)(f) or, alternatively a combination of ITA 8(1)(h) and 8(1)(h.1). A potential problem arises in that:

- The total deducted under ITA 8(1)(f) is limited to commission income.
- A commission salesperson cannot use ITA 8(1)(f) for some costs (e.g., entertainment and advertising costs) and use ITA 8(1)(h) and 8(1)(h.1) for his travel costs. If he uses ITA 8(1)(f), he cannot use ITA 8(1)(h) and 8(1)(h.1).

This means that if he is deducting items like entertainment and advertising, which can only be deducted under ITA 8(1)(f), he will have to deduct travel costs under that provision as well. This procedure may result in exceeding the commission income limit.

In order to deal with this problem, separate calculations must be made for ITA 8(1)(f) including motor vehicle and travel costs, and for the total of motor vehicle and travel costs under ITA 8(1)(h) and ITA 8(1)(h.1). Note that the deductions available under ITA 8(1)(i) and ITA 8(1)(j) are not affected by the choice of ITA 8(1)(f) vs. ITA 8(1)(h) and 8(1)(h.1).

The relevant expense deduction calculations are as follows:

	ITA 8(1)(f) (Limited to $22,310)	**ITA 8(1) (h) and (h.1)**	**ITA 8(1) (i) and (j)**
Automobile Costs:			
Operating Costs			
[(38,000/45,000)($11,420)]	$9,644	$9,644	-
Financing Costs			
[(38,000/45,000)($2,300)]	-	-	$1,942
CCA [(38,000/45,000)($4,500)]	-	-	3,800
Professional Dues	-	-	375
Work Space In The Home Costs:			
Interest On Mortgage	-	-	-
Property Taxes [(25%)($3,850)]	963	-	-
Utilities [(25%)($1,875)]	-	-	469
Insurance [(25%)($960)]	240	-	-
Maintenance [(25%)($3,640)]	-	-	910
Travel Costs	24,600	24,600	-
Non-Deductible Meals			
[(50%)($10,300)] (Note 1)	(5,150)	(5,150)	-
Total Golf Club Fees (Note 2)	Nil	-	-
Entertainment ($845 + $275)	1,120	-	-
Non-Deductible Entertainment			
[(50%)($1,120)] (Note 3)	(560)	-	-
Total	$30,857	$29,094	$7,496

Note 1 Mr. Robinson can deduct 50 percent of his meals while traveling for his employer. Whether the meals are with clients or not does not affect the deductibility.

Note 2 Golf memberships are not deductible. Since the golf club is located in the city he lives in and where his employer is located, meals with clients there would not be deductible at all as they did not occur while Mr. Robinson was traveling for employment related activities.

Note 3 Mr. Robinson can deduct 50 percent of the tickets he purchased as entertainment costs. Unlike meals with clients, whether or not the client entertainment occurred while he was travelling does not affect the deductibility. In ITA 8(1)(f) meals anywhere would be deductible (within limitations) if it were not for ITA 8(4) which targets "meals" only as deductible under ITA 8(1)(f) or (h) if they are incurred while away for at least 12 hours. Since the tickets are not "meals" then that overnight restriction would not apply. Salesperson expenses are all deductible when incurred close to home, with meals being the only exception.

The required calculation of minimum Net Employment Income would be as follows:

Salary	$183,000
Commissions	22,310
Expenses ($29,094 + $7,496 - Note 4)	(36,590)
RPP Contributions (Note 5)	(3,750)
Awards ($550 - $500 + $200) (Note 6)	250
Stock Option Benefit (Note 7)	875
Net Employment Income	$166,095

Note 4 The deduction of dues and other expenses under ITA 8(1)(i) and automobile capital costs (CCA and financing costs) under ITA 8(1)(j) is permitted without regard to other provisions used.

The deduction for work space in the home costs has been split between ITA 8(1)(i) and (f). Since the utilities and maintenance portions can be deducted under ITA 8(1)(i) by any employee, it is not limited by the commission income. The insurance and property tax components are limited as they are deducted under ITA 8(1)(f). A limitation, which is not illustrated in this problem, prevents the deduction of work space in the home costs from creating an employment loss.

As the ITA 8(1)(f) amount is limited to the $22,310 in commission income, the total deduction using ITA 8(1)(f), (i) and (j), is $29,806 ($22,310 + $7,496).

Using the combination of ITA 8(1)(h), (h.1), (i), and (j) produces a deduction of $36,590 ($29,094 + $7,496). Note that when this approach is used, work space in the home costs are limited to utilities and maintenance. Further, there is no deduction for entertainment costs. However, this approach results in deductions totaling $6,784 ($36,590 - $29,806) more than the amount available using ITA 8(1)(f), (i), and (j) due to the effect of the commission income limit.

Note 5 The employer's contributions to the RPP are not considered to be a taxable benefit.

Note 6 An employee can receive any number of non-cash, non-performance awards and, as long as the total is less than $500 for the year, there is no taxable benefit. In this case, Mr. Robinson receives non-cash awards of $550 ($375 + $175). The extra $50 ($550 - $500) will have to be included in income. In addition, he will have to include the gift certificate for $200 as it would be considered a near cash award. Note that he could also have received a long-service award of up to $500 on a tax free basis. However, it does not appear that such an award was given.

Note 7 There is an employment income inclusion on the exercise of the stock options of $875 [(250)($14.75 - $11.25)]. While there is a deduction equal to one-half of this amount available, it is a deduction from Taxable Income and does not enter into the calculation of net employment income. There is also a taxable capital gain on the sale of the 100 shares, but that too does not enter into the calculation of net employment income.

TIF Solution Three - 15

As Mr. Segovia's income includes commissions, he has a choice of deducting his expenses under a combination of ITA 8(1)(f), (i), and (j) or, alternatively under a combination of ITA 8(1)(h), (h.1), (i), and (j).

Deductions under ITA 8(1)(f) are limited to the amount of commissions earned. Alternatively, traveling costs and motor vehicle costs other than capital costs can be deducted under ITA 8(1)(h) and ITA 8(1)(h.1). Deductions under these provisions are not limited to commission income. As discussed in the text, he cannot use both ITA 8(1)(f) and the combination of ITA 8(1)(h) and (h.1).

As the deduction under ITA 8(1)(f) is limited by commission income, alternative calculations are required to determine the maximum deduction. In the calculations which follow, we have minimized the effect of the commission income limit by listing any item that can be deducted under either ITA 8(1)(f) or ITA 8(1)(i) or (j) under the ITA 8(1)(i) and (j) column. These calculations are as follows:

	ITA 8(1)(f) (Limited to $18,500)	ITA 8(1) (h) and (h.1)	ITA 8(1) (i) and (j)
Professional Dues	-	-	$ 450
Automobile Costs:			
Operating Costs [(45,000/60,000)($7,500)]	$5,625	$5,625	-
Financing Costs [(45,000/60,000)($2,250)]	-	-	1,688
CCA [(45,000/60,000)($7,650)]	-	-	5,738
Work Space In The Home Costs:			
Utilities [(35%)($2,600)]	-	-	910
Maintenance [(35%)($1,450)]	-	-	508
Insurance [(35%)($1,250)]	438	-	-
Property Taxes [(35%)($4,800)]	1,680	-	-
Interest	-	-	-
CCA	-	-	-
Travel Costs	29,000	29,000	-
Non-Deductible Meals [(50%)($9,500)]	(4,750)	(4,750)	-
Total Golf Club Fees*	Nil	-	-
Total	$31,993	$29,875	$9,294

*Golf memberships are not deductible. Since the golf club is local, meals with clients there would not be deductible at all as they did not occur while Mr. Segovia was traveling for employment related activities.

The required calculation of minimum Net Employment Income would be as follows:

Salary	$252,000
Commissions	18,500
Expenses ($29,875 + $9,294 - Note 1)	(39,169)
RPP Contributions (Note 2)	(5,500)
Awards ($300 + $450 - $500 + $400 - Note 3)	650
Stock Option Benefit (Note 4)	11,000
Net Employment Income	$237,481

Note 1 The deduction of dues and other expenses under ITA 8(1)(i) and automobile capital costs (CCA and financing costs) under ITA 8(1)(j) is permitted without regard to other provisions used.

The deduction for work space in the home costs has been split between ITA 8(1)(i) and (f). Since the maintenance portion can be deducted under ITA 8(1)(i) by any employee, it is not limited by the commission income. The insurance and property tax components are limited as they are deducted under ITA 8(1)(f). A limitation, which is not illustrated in this problem, prevents the deduction of work space in the home costs from creating an employment loss.

As the ITA 8(1)(f) amount is limited to the $18,500 in commission income, the total deduction using ITA 8(1)(f), (i) and (j), is $27,794 ($18,500 + $9,294).

Using the combination of ITA 8(1)(h), (h.1), (i), and (j) produces a deduction of $39,169 ($29,875 + $9,294). Note that when this approach is used, work space in the home costs are limited to utilities and maintenance. Further, there is no deduction for entertainment costs. However, this approach results in deductions totaling $11,375 ($39,169 - $27,794) more than the amount available using ITA 8(1)(f), (i), and (j) due to the effect of the commission income limit.

Note 2 The employer's contributions to the RPP are not considered to be a taxable benefit.

Note 3 An employee can receive any number of non-cash, non-performance awards and, as long as the total is less than $500 for the year, there is no taxable benefit. In this case, Mr. Segovia receives non-cash awards of $750 ($300 + $450). The extra $250 ($750 - $500) will have to be included in income. In addition, he will have to include the gift certificate for $400 as it would be considered a near cash award. Note that he could also have received a long-service award of up to $500 on a tax free basis. However, it does not appear that such an award was given.

Note 4 There is an employment income inclusion on the exercise of the stock options of $11,000 [(1,000)($31 - $20)]. While there is a deduction equal to one-half of this amount available, it is a deduction from Taxable Income and does not enter into the calculation of net employment income.

TIF Solution Three - 16

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

Salary	$82,500
Commissions	8,400
Registered Pension Plan Contributions	(4,200)
Union Dues	(375)
Non-Cash Gift (<$500)	Nil
Stock Option Benefit (Note One)	5,500
Stock Option Deduction	Nil
Automobile Benefit (Note Two)	Nil
Employment Expenses (Note Three)	(9,200)
Net Employment Income	$82,625

Note One The employment income benefit would be calculated as follows:

Market Value Of Shares [(500)($37)]	$18,500
Adjusted Cost Base [(500)($26)]	(13,000)
Employment Income Inclusion	$ 5,500

Mr. Karson would be entitled to a deduction of $2,750 [(1/2)($5,500)] under ITA 110(1)(d). However, this would be a deduction in the determination of Taxable Income and would not influence the determination of net employment income.

Mr. Karson would also have a taxable capital gain of $250 [(1/2)(1/2)(500)($39 - $37)]. However, this gain would not be included in net employment income.

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

Standby Charge [(2/3)(10)($725 - $75)(11,000/16,670)]	$2,859
Operating Cost Benefit - Lesser Of:	
• [(11,000)($0.26)] = $2,860	
• [(1/2)($2,859)] = $1,430	1,430
Total Before Payments	$4,289
Payments For Personal Use [(11,000)($0.45)]	(4,950)
Taxable Benefit	$ Nil

As Mr. Karson's employment related usage is more than 50 percent, he can elect to use one-half the standby charge as the operating cost benefit.

Note Three The total potential deduction for expenses is $14,950 [($4,200 + (1/2)($3,100) + $9,200). While all of these items could be deducted under ITA 8(1)(f), this deduction is limited to Mr. Karson's commission income of $8,400. While the advertising and entertainment costs cannot be deducted under ITA 8(1)(h), travel costs can be deducted without limit. Given this, Mr. Karson would minimize net employment income by deducting the $9,200 in travel costs under ITA 8(1)(h). Note that he cannot use both 8(1)(f) and 8(1)(h) in the same taxation year.

Chapter Four Test Item File Solutions

TIF Solution Four - 1

1. The reason for this approach being used is based on the fact that there are a number of items that influence an individual's tax obligation that are altered on the basis of the individual's Net Income For Tax Purposes. For example, the amount of the age tax credit is reduced by the individual's Net Income For Tax Purposes in excess of a specified amount (a.k.a. the threshold amount or the income threshold). In order to ensure that income tests of this type are applied on an equitable basis, amounts are left in Net Income For Tax Purposes even in situations where the ultimate intent is not to assess tax on these amounts.

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

3. An individual's income for the entire taxation (calendar) year, other than business income, is subject to tax in the province in which he resides on the last day of the taxation year. Which province assesses income tax is a very important tax planning issue. Maximum provincial rates vary from 15 percent to nearly 26 percent. In addition, the value of the personal tax credits varies between the provinces. Clearly, what province an individual is taxed in can make a great deal of difference with respect to the amount of income taxes that will be paid.

4. A "tax deduction" is an amount subtracted in the determination of Net Income For Tax Purposes. This reduction in Net Income For Tax Purposes will flow through to Taxable Income and reduce Tax Payable by the amount of the deduction, multiplied by the relevant tax rate. In contrast, a "tax credit" provides a direct reduction in the amount of Tax Payable. Because of this difference, on a dollar-for-dollar basis, tax credits are more valuable than tax deductions.

5. The three credits are the:
   - spouse or common-law partner credit
   - eligible dependant credit
   - caregiver credit

   (Not Required) This amount is automatically included in the base for the infirm dependant over 17 tax credit. In addition, it is available as a stand alone credit for children under the age of 18.

6. An individual's spouse is a person to whom that individual is legally married. A common-law partner is an individual who is not a spouse and who cohabits in a conjugal relationship with the taxpayer and (a) has so cohabited with the taxpayer for a continuous period of at least one year, or (b) is a parent of a child of whom the taxpayer is a parent. Spouses and common-law partners may be either the same sex or of the opposite sex.

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

8. Such a taxpayer could claim the eligible dependant credit, including the Family Caregiver Amount.

9. The family caregiver amount will not always be added to the caregiver amount. In most cases, qualifying for the caregiver credit requires the individual to have a mental or physical infirmity. However, there is an exception for parents or grandparents over the age of 64. As they do not have to be mentally or physically infirm to qualify for the caregiver tax credit, they would not be eligible for the family caregiver amount to be added to the base for this credit.

10. In general, both credits require the qualifying individual to be over 17 years of age and mentally or physically infirm. The first factor that must be considered is whether the dependant lives with the taxpayer in the taxpayer's self-contained domestic establishment. If the dependant does not live with the taxpayer, the caregiver credit is not available.

    If the dependant lives with the taxpayer, the next factor relates to eligibility. To qualify for the caregiver credit including the family caregiver amount, the individual must be mentally or physically infirm.

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

11. The three qualifying types could be selected from the following:

    - periodic payments from a Registered Pension Plan (RPP);
    - an annuity payment out of a Registered Retirement Savings Plan (RRSP);
    - a payment out of a Registered Retirement Income Fund (RRIF);
    - an annuity payment from a Deferred Profit Sharing Plan (DPSP); and
    - the interest component of other annuities.

    A non-qualifying type could be selected from the following:

    - payments under the Old Age Security Act or Canada Pension Plan;
    - payments under certain provincial pension plans;
    - payments under salary deferral arrangements;
    - payments under retirement compensation arrangements;
    - payments under an employee benefit plan; and
    - death benefits.

12. Normally the organization issuing the receipt will specify the amounts paid that qualify for either of the credits, or for child care costs. Both credits can be claimed for a specific child, but the same fees cannot be used as a base for both credits.

13. The likely reason is the belief that limiting this tax credit to the low federal rate of 15 percent would discourage large donations by high income individuals. Stated alternatively, it appears that policy makers believed that the use of the high 29 and 33 percent rates was necessary in order to encourage high tax bracket individuals to continue making significant donations.

14. Any claims that are not made in the current year can be carried forward and used as the base for the charitable donations tax credit in the subsequent five years. There is the possibility that the amount claimed in the year of contribution could result in a tax credit that is larger than the individual's Tax Payable in that year. If that is the case, the extra amount claimed is simply wasted. Better tax planning would have the taxpayer carry some amount forward to be used as the base for a credit in a year in which he has additional Tax Payable.

    The carry forward could be particularly advantageous if the first-time donor super credit (FDSC) is available. Since the FDSC can only be claimed in one taxation year, carrying forward donations up to the $1,000 maximum would result in a higher claim for the FDSC.

15. The base for medical expenses is reduced by the lesser of 3 percent of the taxpayer's Net Income For Tax Purposes and $2,237 (for 2016). If, for example, an individual had large medical costs in the second half of 2015 and the first half of 2016, deducting the sum of these costs in the 12 month period ending June 30, 2016 would result in only one reduction. In contrast, if the relevant amounts were deducted in each of the two calendar years, the lesser reduction would be applied twice, once in 2015, and again in 2016.

16. In general, the medical expense credit should be claimed by the lower income spouse. This is because the amount of medical expenses must be reduced by the lesser of $2,237 (for 2016) and 3 percent of the individual's income. This figure will be lower for the lower income spouse so the medical expense credit will be larger. Exceptions to this general rule are:

    - If both spouses have income such that 3 percent exceeds the $2,237 threshold, it does not matter which spouse claims the credit.
    - If the lower income spouse does not have sufficient Tax Payable to use the medical expense tax credit, it should be claimed by the higher income spouse.

17. It can be transferred provided the supporting person can claim the disabled person as a:

    - a dependant under the eligible dependant provision [ITA 118(1)(b)];
    - a dependant for purposes of the caregiver tax credit [ITA 118(1)(c.1)]; or
    - a mentally or physically infirm dependant over 17 [ITA 118(1)(d)].

    In addition, it can be claimed if the supporting person:

    - could have claimed the eligible dependant credit, if neither the supporting person nor the disabled dependant were married; or
    - could have claimed the disabled dependant over 17, or the caregiver credit, if the dependant had been 18 years of age or older and had no income.

18. The following types of fees are eligible for this credit:

- Tuition fees over $100 paid to a university, college, or other institution for post-secondary courses located in Canada.
- Tuition fees paid to an institution certified by the Minister of Human Resources and Skills Development for a course that developed or improved skills in an occupation (the individual must be 16 or older).
- Tuition fees paid to a university outside Canada. To qualify the course must have a minimum duration of 3 weeks.
- For individuals who live near the U.S. border and commute, tuition fees paid to a U.S. college or university for part-time studies.

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

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

21. For 2016, the OAS clawback claims 15 percent of each dollar of income in excess of $73,756. At this income level, the individual is already subject to a federal marginal tax rate of 20.5 percent. In effect, the clawback represents an additional 15 percentage points of taxation, resulting in an overall federal rate of 35.5 percent. When combined with an average provincial rate, this pushes the overall rate for these individuals to well over 50 percent.

TIF Solution Four - 2

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

2. True.

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

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

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

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

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

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

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

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

11. True.

12. False. Any required repayment of OAS payments can be deducted in the determination of Net Income For Tax Purposes.

TIF Solution Four - 3

New For 2016/2017

1. B. A business loss incurred during the current year.

2. D. $100,001 {$90,563 + [($18,529 - $16,075) ÷ 26%]}

3. B. Income that is not taxed in a province is subject to an additional tax at the federal level.

4. A To claim the eligible dependant credit for a child, the child must be under the age of 18 at some time during the year. If the child is mentally or physically infirm, they do not have to be under 18.

5. C. The required amount would be calculated as follows:

15 Percent Of $200	$ 30
33 Percent Of The Lesser Of:	
• $74,800 ($75,000 - $200)	
• $30,000 ($230,000 - $200,000)	
= [(33%)($30,000)]	9,900
29 Percent Of $44,800 [$75,000 - ($30,000 + $200)]	12,992
Total Credit	$22,992

6. C. For 2016, the maximum children's fitness credit is $150 [(15%)($1,000)]. If the child qualifies for the disability tax credit, there is a supplement amount of $500 that can be available. Note that A is incorrect as it is possible for an organization to issue 2 separate tax receipts for a program as long as the total of the two receipts is less than the fees paid.

Retained From Previous Editions

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

Taxable Benefit [($50,000)(4%)(6/12)]	$1,000
Reduction For Payments [($50,000)(3%)(6/12)]	(750)
Total ITA 80.4(1) Benefit	$ 250
Home Relocation Loan Deduction - Lesser Of:	
• Benefit = $250	
• [(4%)($25,000)(2/4)] = $500	(250)
Net Addition To Taxable Income	$ Nil

8. A. $8,750. This would be calculated as follows:

Taxable Benefit Under ITA 80.4(1)(a) - Lesser Of:	
• [($200,000)(5%)] = $10,000	
• [($200,000)(6%)] = $12,000	$10,000
Reduction For Payments	Nil
Total ITA 80.4(1) Benefit	$10,000
Home Relocation Loan Deduction - Lesser Of:	
• Benefit = $10,000	
• [(5%)($25,000)] = $1,250	(1,250)
Net Addition To Taxable Income	$ 8,750

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

10. C. Total federal tax minus federal tax credits equals federal tax payable

11. C. $60,931 {$45,282 + [($10,000 - $6,792) ÷ 20.5%]}

12. D. All provinces use the same tax brackets for applying their rates.

13. A. caregiver, employment credit, medical expenses, disability

14. D. Pension income amount.

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

16. B. It can be claimed by either spouse.

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

18. C. A person may claim 75% of his or her Net Income For Tax Purposes in charitable donations for a single year ($90,000 in this case). As none of his income is taxed at 33 percent, this rate will not be applicable to the calculation of the charitable donations tax credit. The donation credit is 15% of the first $200, plus 29% of the excess, for a total of $26,072.

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

20. D. All of the above.

21. D. The EI and CPP credits.

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

23. A. His wife and son

24. C. Mentally infirm spouse age 65

25. B. Mentally infirm grandchild age 16

26. C. Union Dues

27. C. Disability tax credit and Infirm Dependant over 17 tax credit only

28 D. No tax credits available.

29. C. ($11,474 + $2,544 + $955 + $1,161) x 15% = $2,420

30. B. $4,237 ($300 ÷ 15%) + $2,237

31. C. $308 [$2,500 – ($15,000 x 3%)] x 15%

32. D. $166 [($300 x 3/4) – [($200 x 15%) + ($100 x 29%)]

33. A. $468 [8 x ($120 + $20) + (4 x $500) x 15%]

34. D. Fees paid to a day care centre

35. C. Canada Employment tax credit (must have employment income)

36. B. Age tax credit (net income is too high)

37. C. Credits related to tuition paid to a university outside of Canada cannot be transferred to another person.

TIF Solution Four - 4

Exam Exercise Solution Four - 1 (Home Relocation Loan)

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

Interest At Prescribed Rate [(5%)($78,000)]	$3,900
Reduction For Payments Made By Ms. Rossi [(1%)($78,000)]	(780)
ITA 80.4(1) Benefit	$3,120
ITA 110(1)(j) Deduction - Lesser Of:	
• ITA 80.4(1) Benefit = $3,120	
• [($25,000)(5%)] = $1,250	(1,250)
Addition To Taxable Income	$1,870

Exam Exercise Solution Four - 2 (Home Relocation Loan)

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

Interest At Prescribed Rate [(3%)($125,000)]	$3,750
Reduction For Payments Made By Ms. Hill [(1%)($125,000)]	(1,250)
ITA 80.4(1) Benefit	$2,500
ITA 110(1)(j) Deduction - Lesser Of:	
• ITA 80.4(1) Benefit = $2,500	
• [($25,000)(3%)] = $750	(750)
Addition To Taxable Income	$1,750

Exam Exercise Solution Four - 3 (Calculation Of Tax Payable Before Credits)

The required Tax Payable would be calculated as follows:

Federal Tax Payable:	
On First $45,282	$6,792
On Next $7,893 ($53,175 - $45,282) At 20.5 Percent	1,618
Federal Tax Payable Before Credits	$8,410

Exam Exercise Solution Four - 4 (Calculation Of Tax Payable Before Credits)

The required Tax Payable would be calculated as follows:

Federal Tax Payable:	
On First $90,563	$16,075
On Next $1,922 ($92,485 - $90,563) At 26 Percent	500
Federal Tax Payable Before Credits	$16,575

Exam Exercise Solution Four - 5 (Spousal Tax Credit With FCA)

The required amount would be calculated as follows:

Basic Personal Amount	$ 11,474
Spousal ($11,474 + $2,121 - $5,800)	7,795
Credit Base	$19,269
Rate	15%
Total Credits	$ 2,890

Exam Exercise Solution Four - 6 (Spousal Tax Credit)

The required amount would be calculated as follows:

Basic Personal Amount	$ 11,474
Spousal ($11,474 - $8,420)	3,054
Credit Base	$14,528
Rate	15%
Total Credits	$ 2,179

Exam Exercise Solution Four - 7 (Caregiver Tax Credit)

Gerrard would be entitled to a caregiver tax credit in the amount of $331 {[15%][$4,667 - ($18,400 - $15,940)]}. As his mother does not appear to be physically or mentally disabled, the family caregiver amount is not added to this credit.

Exam Exercise Solution Four - 8 (Caregiver Tax Credit)

Elaine's mother would qualify for the caregiver tax credit and, because she is dependent on Elaine because of a physical infirmity, the family caregiver amount is added to this credit. As Elaine's mother's income is below the income threshold for the caregiver tax credit, the total credit would equal $1,018 [(15%)($4,667 + $2,121)].

Exam Exercise Solution Four - 9 (Infirm Dependant Over 17 Tax Credit)

Margo would be entitled to an infirm dependant over 17 tax credit in the amount of $1,001 {[15%][$6,788 - ($6,920 - $6,807)]}. She could not claim the caregiver credit as her son does not live with her.

Exam Exercise Solution Four - 10 (Infirm Dependant Over 17 Tax Credit Vs. Caregiver Tax Credits)

Farah's daughter qualifies for both the infirm dependant over 17 credit and the caregiver credit. In this situation, ITA 118(4)(d) deems the daughter not to be a dependant and, in effect requires the use of the caregiver credit. As the daughter is dependent because of a physical disability, the family caregiver amount is added. Since the daughter's income is below the income threshold for the caregiver tax credit, the total credit would equal $1,018 [(15%)($4,667 + $2,121)].

Exam Exercise Solution Four - 11 (Eligible Dependent Vs. Caregiver Tax Credits)

As the father qualifies for the eligible dependant credit, Sheila cannot take the caregiver tax credit. Given this she would first determine the amount of the eligible dependant credit as follows:

[(15%)($11,474 - $7,675)] = $570

As her father's income is below the $15,940 threshold for the caregiver credit, in the absence of ITA 118(4)(c), she would have been eligible for $700, the full amount of the caregiver credit. This means that she will have an additional credit under ITA 118(1)(e) of $130 ($700 - $570). The combination of the eligible dependant credit and the ITA 118(1)(e) credit totals $700, the maximum caregiver credit.

Exam Exercise Solution Four - 12 (Eligible Dependent Vs. Caregiver Tax Credits)

Gloria's mother qualifies for both the eligible dependant tax credit and the caregiver tax credit, including the family caregiver amount. In this situation, Gloria cannot take the caregiver amount and must take the eligible dependant credit. However, because of the high level of her mother's income, this credit would be nil:

[(15%)($11,474 + $2,121 - $17,200)] = Nil

If she had been able to claim the caregiver amount and FCA, it would have been $829 {[15%][($4,667 + $2,121) - ($17,200 - $15,940)]}.

Given this, she will receive a credit under ITA 118(1)(e) of $829 ($829 - Nil).

Exam Exercise Solution Four - 13
(Caregiver Vs. Infirm Dependent Over 17 Tax Credits)

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

[(15%)($4,667 + $2,121 - Nil)] = $1,018

Exam Exercise Solution Four - 14 (Multiple Credits For Dependants)

The daughter qualifies for the eligible dependant credit, the infirm dependant over 17 credit, and the caregiver tax credit. However, if the eligible dependant credit is taken for the son, the fact that this claim can only be made for one dependant means that the daughter is no longer eligible for this credit. This leaves the infirm dependant over 17 and caregiver credits for the daughter. In these circumstances, ITA 118(4)(d) requires that he claim the caregiver credit. As the daughter is dependent because of a physical disability, the family caregiver amount is added. Given these considerations, the maximum credits would be calculated as follows:

Basic Personal Amount	$ 11,474
Eligible Dependant - Son ($11,474 - $2,100)	9,374
Caregiver Including FCA - Daughter ($4,667 + $2,121)	6,788
Credit Base	$27,636
Rate	15%
Total Credits	$ 4,145

Exam Exercise Solution Four - 15 (Multiple Credits For Dependants)

The son qualifies for the eligible dependant credit, the infirm dependant over 17 credit, and the caregiver tax credit. However, if the eligible dependant credit is taken for the daughter, the fact that this claim can only be made for one dependant means that the son is no longer eligible for this credit. This leaves the infirm dependant over 17 and caregiver credits for the son. In these circumstances, ITA 118(4)(d) requires that she claim the caregiver credit. As the son is dependent because of a physical disability, the family caregiver amount is added. Given these considerations, the maximum credits would be calculated as follows:

Basic Personal Amount	$ 11,474
Eligible Dependant - Daughter ($11,474 - $1,230)	10,244
Caregiver Including FCA - Son ($4,667 + $2,121)	6,788
Credit Base	$28,506
Rate	15%
Total Credits	$ 4,276

Exam Exercise Solution Four - 16 (Age Tax Credit)

Ms. Burns' age credit would be $828 {[15%][$7,125 - (15%)($46,642 - $35,927)]}.

Exam Exercise Solution Four - 17 (Age Tax Credit)

Mr. Rose's age credit would be $471 {[15%][$7,125 - (15%)($62,485 - $35,927)]}.

Exam Exercise Solution Four - 18 (Adoption Expenses Tax Credit)

The adoption expenses tax credit would be calculated as follows:

Cost Of First Trip To France	$ 3,850
Cost Of Second France Trip	6,280
French Orphanage Fee	1,759
Canadian Adoption Agency Fee	5,600
Legal Fees	3,250
Medical Costs (Qualify For Medical Expense Credit)	Nil
Total Eligible Expenses	$20,739

Since the $4,500 employer reimbursement is a taxable benefit and included in employment income, it does not reduce the total eligible adoption expenses.

The adoption period begins at the time that an application is made for registration with a provincial ministry. This means that all of the expenses listed in the preceding table would be eligible expenses made during the adoption period. However, for 2016, there is an overall limit of $15,453. Given this, the maximum credit that can be claimed is $2,318 [(15%)($15,453)].

Exam Exercise Solution Four - 19 (Home Accessibility Tax Credit)

The addition to the truck is not a qualifying expenditure. The base for the home accessibility tax credit is the lesser of:

- The actual qualifying home accessibility costs.
- $10,000.

The lesser of these two figures is the actual costs of $8,600, resulting in a tax credit of $1,290 [(15%)($8,600)].

Exam Exercise Solution Four - 20 (Charitable Donations Tax Credit)

The credit base for 2016 would be limited to $52,800 [(75%)($70,400)]. However, he chooses to claim $15,000, leaving a carry forward of $105,000 ($120,000 - $15,000). Note that, because Leon's Taxable Income is below the $200,000 threshold at which the 33 percent rate applies, this rate is not relevant in the following calculation. The resulting credit would be:

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

As his income for 2017 is unchanged from 2016, the limit would be the same $52,800 [(75%)($70,400)]. In general, charitable donations can be carried forward for up to 5 years. As a result, the final year to claim any unused portion of his 2016 donation would be 2021.

Exam Exercise Solution Four - 21 (Charitable Donations Tax Credit - FDSC)

The credit base for 2016 would be limited to $52,800 [(75%)($70,400)]. However, he chooses to claim $15,000, leaving a carry forward of $105,000 ($120,000 - $15,000). Note that, because Leon's Taxable Income is below the $200,000 threshold at which the 33 percent rate applies, this rate is not relevant in the following calculation. The resulting credit would be:

$200 At 15 Percent	$ 30
$14,800 ($15,000 - $200) At 29 Percent	4,292
Total Regular Credit	$4,322
First Time Donor's Super Credit [(25%)($1,000)]	250
Total Credit	$4,572

As his income for 2017 is unchanged from 2016, the limit would be the same $52,800 [(75%)($70,400)]. In general, charitable donations can be carried forward for up to 5 years. As a result, the final year to claim any unused portion of his 2016 donation would be 2021.

Exam Exercise Solution Four - 22 (Charitable Donations Tax Credit)

The credit base for 2016 would be limited to $62,250 [(75%)($83,000)]. However, he chooses to claim $30,000, leaving a carry forward of $90,000 ($120,000 - $30,000). Note that, because Jack's Taxable Income is below the $200,000 threshold at which the 33 percent rate applies, this rate is not relevant in the following calculation. The resulting credit would be:

$200 At 15 Percent	$ 30
$29,800 ($30,000 - $200) At 29 Percent	8,642
Total Credit	$8,672

As his income for 2017 is unchanged from 2016, the limit would be the same $62,250 [(75%)($83,000)]. In general, charitable donations can be carried forward for up to 5 years. As a result, the final year to claim any unused portion of his 2016 donation would be 2021.

Exam Exercise Solution Four - 23 (Medical Expense Tax Credit)

The required calculation is as follows:

Amount B Expenses For Samuel And Spouse		$2,042
Amount C		
Lesser Of:		
• [(3%)($125,000)] = $3,750		
• 2016 Threshold Amount = $2,237		(2,237)
Subtotal		Nil
Amount D		
Son’s Medical Expenses	$7,780	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)($8,675)] = $260	(260)	7,520
Allowable Amount Of Medical Expenses		$7,520
Amount A The Appropriate Rate		15%
Medical Expense Tax Credit		$1,128

Exam Exercise Solution Four - 24 (Medical Expense Tax Credit)

The required calculation is as follows:

Amount B Expenses For Saul, His Spouse, And His Daughter		$4,500
Amount C		
Lesser Of:		
• [(3%)($70,000)] = $2,100		
• 2016 Threshold Amount = $2,237		(2,100)
Subtotal		$2,400
Amount D		
Son's Medical Expenses	$6,200	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)($9,200)] = $276	(276)	5,924
Allowable Amount Of Medical Expenses		$8,324
Amount A The Appropriate Rate		15%
Medical Expense Tax Credit		$1,249

Exam Exercise Solution Four - 25 (Refundable Medical Expense Supplement)

The regular medical expense credit would be calculated as follows:

Medical Expenses	$10,325
Lesser Of:	
• [(3%)($28,248)] = $847	
• 2016 Threshold Amount = $2,237	(847)
Allowable Amount Of Medical Expenses	$ 9,478

The refundable supplement would be calculated as follows:

Lesser Of:	
• $1,187 (2016 Maximum)	
• [(25%)($9,478)] = $2,370	$1,187
Reduction [(5%)($28,248 - $26,277)]	(99)
Refundable Medical Expense Supplement	$1,088

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

Tax Payable Before Credits [(15%)($28,248)]		$4,237
Non-Refundable Credits:		
Basic	$11,474	
Common-Law Partner	11,474	
Allowable Medical Expenses	9,478	
Total	$32,426	
Rate	15%	(4,864)
Tax Before Refundable Supplement		Nil
Refundable Supplement		(1,088)
Tax Payable (Refund)		($1,088)

Exam Exercise Solution Four - 26 (Disability Tax Credit)

As Marie has no income, the regular disability credit can be transferred to Lorraine. However, as Marie is over 17, the disability supplement is not available.

In addition to the disability credit, Lorraine will be able to claim the caregiver credit and the family caregiver amount, as well as a credit for all of Marie's medical expenses. Note, however, that because Marie qualifies for the caregiver credit, the infirm dependant over 17 credit is not available.

The total credits related to Marie would be as follows:

Transfer Of Marie's Disability - Regular Amount		$ 8,001
Caregiver Including FCA ($4,667 + $2,121)		6,788
Marie's Medical Expenses	$9,850	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)(Nil)]	Nil	9,850
Total Credit Base		$24,639
Rate		15%
Total Credits Related To Marie		$ 3,696

Exam Exercise Solution Four - 27 (Disability Tax Credit)

Given that Suzanne's income is less than the basic personal tax credit, the disability tax credit can be transferred to her father. In addition, because she is under 18, she is eligible for the disability supplement and the family caregiver amount. As none of her medical expenses were for attendant care, the full amount of the supplement is available.

He will also be able to benefit from the Family Caregiver Amount for a child under 18.

As Larry and his wife have medical expenses that exceed the income threshold, and Suzanne's income is not a factor since she is under 18, he can claim all of Suzanne's medical expenses.

The total credits related to Suzanne would be calculated as follows:

Transfer Of Suzanne's Disability - Regular Amount	$ 8,001
Transfer Of Disability Supplement	4,667
Family Caregiver For Child	2,121
Suzanne's Medical Expenses	12,400
Total Credit Base	$27,189
Rate	15%
Total Credits Related To Suzanne	$ 4,078

Exam Exercise Solution Four - 28 (Education Related Tax Credits)

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

Tuition Amount:		
Total	$4,100	
Ineligible Ancillary Fees ($415 - $250)	(165)	$3,935
Education Amount:		
Full Time [(5)($400)]	$2,000	
Part Time [(3)($120)]	360	2,360
Textbook Amount:		
Full Time [(5)($65)]	$ 325	
Part Time [(3)($20)]	60	385
Interest On Student Loan		417
Total Credit Base		$7,097
Rate		15%
Total Available Credits		$1,065

Exam Exercise Solution Four - 29 (Education Related Tax Credits)

Ms. Bucknell's education related tax credits would be calculated as follows:

Tuition Amount:		
Total	$10,400	
Ineligible Ancillary Fees ($350 - $250)	(100)	$10,300
Education Amount:		
Full Time [(6)($400)]	$2,400	
Part Time [(6)($120)]	720	3,120
Textbook Amount:		
Full Time [(6)($65)]	$ 390	
Part Time [(6)($20)]	120	510
Interest On Student Loan		623
Total Credit Base		$14,553
Rate		15%
Total Available Credits		$ 2,183

Exam Exercise Solution Four - 30
(Carry Forward Of Education Related Tax Credits)

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

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

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

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

Karl's Tax Payable before deducting education related credits would be $3,476 [(15%)($34,650 - $11,474)]. This is more than sufficient to absorb the available education related credits and, as a consequence, there would be no carry forward of credits.

Exam Exercise Solution Four - 31 (Transfer Of Education Related Tax Credits)

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

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

Income Tax Act Approach The $750 maximum transfer of education related credits must be reduced by Betty's Tax Payable of $547 [(15%)($15,123 - $11,474)]. This will leave a maximum transfer of $203 ($750 - $547) and a carry forward credit of $3,898 ($4,648 - $547 - $203).

Tax Return Approach The $5,000 maximum transfer of education related amounts must be reduced by $3,649 ($15,123 - $11,474), the excess of Betty's Taxable Income over her basic personal amount. This results in a maximum transfer of $1,351 ($5,000 - $3,649) and would leave a carry forward of $25,985 ($30,985 - $3,649 - $1,351). This would give the same $3,898 [(15%)($25,985)] credit as under the alternative calculation.

Exam Exercise Solution Four - 32 (Transfer Of Education Related Tax Credits)

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

Tuition Amount	$31,400
Education And Textbook Amounts [(8)($400 + $65)]	3,720
Available Education Related Amounts (Maximum Transfer = $5,000)	$35,120
Rate	15%
Available Education Related Credits (Maximum Transfer = $750)	$ 5,268

Income Tax Act Approach The $750 maximum transfer of education related credits must be reduced by Carl's Tax Payable of $101 [(15%)($12,150 - $11,474)]. This will leave a maximum transfer of $649 ($750 - $101) and a carry forward credit of $4,518 ($5,268 - $101 - $649).

Tax Return Approach The $5,000 maximum transfer of education related amounts must be reduced by $676 ($12,150 - $11,474), the excess of Betty's Taxable Income over her basic personal amount. This results in a maximum transfer of $4,324 ($5,000 - $676) and would leave a carry forward of $30,120 ($35,120 - $676 - $4,324). This would give the same $4,518 [(15%)($30,120)] credit as under the alternative calculation.

Exam Exercise Solution Four - 33 (Transfer Of Credits From A Spouse)

Her tax credits would be calculated as follows:

Basic Personal Amount	$ 11,474
Spousal Amount	11,474
Age [$7,125 - (15%)($53,500 - $35,927)]	4,489
Pension Income	2,000
Spousal Age Transfer	7,125
Spousal Tuition, Education, And Textbook Transfer - Lesser Of:	
• $5,000	
• [$3,450 + ($400)(3 Months) + ($65)(3 Months)] = $4,845	4,845
Credit Base	$41,407
Rate	15%
Total Credits	$ 6,211

Exam Exercise Solution Four - 34 (Transfer Of Credits From A Spouse)

John's tax credits would be calculated as follows:

Basic Personal Amount	$ 11,474
Spousal Amount	11,474
Age [$7,125 - (15%)($63,200 - $35,927)]	3,034
Pension Income	2,000
Spousal Age Transfer	7,125
Spousal Tuition, Education, And Textbook Transfer - Lesser Of:	
• $5,000	
• [$4,200 + ($400)(4 Months) + ($65)(4 Months)] = $6,060	5,000
Credit Base	$40,107
Rate	15%
Total Credits	$ 6,016

Exam Exercise Solution Four - 35 (Political Contributions Tax Credit)

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

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

Exam Exercise Solution Four - 36 (Labour Sponsored Funds Credit)

The credit will be $230 [(5%)($4,600)]. As her acquisition is less than the $5,000 maximum, the full cost is eligible for the 5 percent federal credit.

Exam Exercise Solution Four - 37 (EI And OAS Clawbacks)

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

Net Employment Income	$67,200
EI Benefits	9,460
OAS Benefits	7,000
Income Before Deductions	$83,660

Dealing first with the EI repayment, Mr. Clemens would have to repay the lesser of:

- $2,838 [(30%)($9,460)]
- $6,048 [(30%)($83,660 - $63,500)]

Using this deduction, the clawback of the OAS payments would be the lesser of:

- $7,000
- $1,060 [(15%)($83,660 - $2,838 - $73,756)]

As a result, his Net Income For Tax Purposes would be as follows:

Income Before Deductions	$83,660
ITA 60(v.1) Deduction (EI)	(2,838)
ITA 60(w) Deduction (OAS)	(1,060)
Net Income For Tax Purposes	$79,762

Exam Exercise Solution Four - 38 (Tax Payable With OAS Clawback)

Before the deduction of any OAS repayment, Agnes had income as follows:

OAS Payments	$ 7,000
CPP Payments	10,000
Investment Income	65,000
Income Before Deduction	$82,000

The OAS clawback would be the lesser of:

- $7,000
- $1,237 [(15%)($82,000 - $73,756)]

This results in a Taxable Income of $80,763 ($82,000 - $1,237). Using this figure, the Tax Payable for Agnes would be calculated as follows:

Tax On First $45,282	$ 6,792
Tax On Remaining $35,481 ($80,763 - $45,282) At 20.5 Percent	7,274
Tax Before Credits	$14,066
Tax Credits (Given)	(2,500)
Tax Payable Before Clawback	$11,566
Plus: OAS Clawback	1,237
Total Amount Due	$12,803

TIF Solution Four - 5A

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

A. 4

B. 6

C. 2

D. 8

E. 3

F. 1

G. 7

H. 13

I. 19

J. 16

K. 14

L. 18

M. 10

N. 17

O. 12

The four unused definitions are as follows:

Canada Pension Plan = 9

Medical Expense Tax Credit = 5

OAS Benefits = 15

Spousal Tax Credit = 11

TIF Solution Four - 5B

For some terms there is both a 100 percent correct answer and an answer that is close. We have indicated the "close answer" in brackets.

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

A. 5

B. 8

C. 2

D. 11

E. 3 (not 21)

F. 1

G. 9

H. 17 (not 10)

I. 24

J. 20 (not 15)

K. 18

L. 23 (not 7)

M. 13 (not 4)

N. 22

O. 16

The four unused definitions are as follows:

Canada Pension Plan = 12

Medical Expense Tax Credit = 6

OAS Benefits = 19

Spousal Tax Credit = 14

TIF Solution Four - 6

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

1. **Ms. Partridge** will qualify for the following tax credits:

Basic Personal Amount	$11,474
Spousal ($11,474 - $4,725)	6,749
Age [$7,125 - (15%)($61,300 - $35,927)]	3,319
Pension Income	2,000
Total Credit Base	$23,542
Rate	15%
Total Credits	$ 3,531

Note that, because her income is below the $73,756 income threshold, there will be no clawback of Ms. Partridge's OAS receipts.

2. **Mr. Brody** will qualify for the following credits:

Basic Personal Amount	$11,474
Eligible Dependant (See Note)	10,034
Total Credit Base	$21,508
Rate	15%
Total Credits	$ 3,226

Note The eligible dependant credit can be taken for any child. However, it should not be claimed for the 15 year old as the amount of the credit would be reduced due to his income. As Martin included his Universal Child Care Benefits in the Net Income For Tax Purposes of his eligible dependant, the credit for this dependant is $10,034 ($11,474 - $1,440).

3. **Ms. Lassiter** will qualify for the following tax credits:

Basic Personal Amount	$11,474
Spousal ($11,474 - $1,600)	9,874
Medical Expenses (See Note)	16,229
Total Credit Base	$37,577
Rate	15%
Total Credits	$ 5,637

Note The claim for medical expenses is determined as follows:

Expenses For Marion, Her Spouse, And Under 18 Children ($4,240 + $3,450 + $1,860 + $2,450)		$12,000
Reduced By The Lesser Of:		
• [(3%)($132,450)] = $3,974		
• 2016 Threshold Amount = $2,237		(2,237)
19 Year Old's Medical Expenses	$6,720	
Reduced By The Lesser Of:		
• [(3%)($8,460)] = $254		
• $2,237	(254)	6,466
Allowable Medical Expenses		$16,229

4. **Ms. Archer** will qualify for the following credits:

Basic Personal Amount	$11,474
Spousal ($11,474 - $7,240)	4,234
Caregiver Including FCA ($4,667 + $2,121)	6,788
Total Credit Base	$22,496
Rate	15%
Total Credits	$ 3,374

Note The 22 year old disabled child qualifies for both the caregiver and infirm dependant over 17 credits. In such situations, ITA 118(4)(d), in effect, requires the use of the caregiver credit. Also note that, because the 22 year old son is physically infirm, the caregiver credit includes the family caregiver amount.

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

Basic Personal Amount	$11,474
Spousal ($11,474 - $4,230)	7,244
EI (Maximum)	955
CPP (Maximum)	2,544
Canada Employment	1,161
Total Credit Base	$23,378
Rate	15%
Total Credits	$ 3,507

TIF Solution Four - 7

Case 1

The solution for this Case is as follows:

Tax [(15%)($44,500)]		$6,675
Basic Personal Amount	($11,474)	
Spousal Including FCA ($11,474 + $2,121 - $8,880)	(4,715)	
Age [$7,125 - (15%)($44,500 - $35,927)]	(5,839)	
Pension	(2,000)	
Spouse's Age	(7,125)	
Spouse's Disability	(8,001)	
Spouse's Pension (= RPP Payments)	(1,230)	
Credit Base	($40,384)	
Rate	15%	(6,058)
Federal Tax Payable		$ 617

As Billy is infirm, the family caregiver amount is added to the spousal credit. The Old Age Security and Canada Pension Plan receipts are not eligible for the pension income credit, only the Registered Pension Plan receipts are eligible. As Billy's income is below $35,927, there is no reduction in his age credit.

Case 2

The solution for this Case is as follows:

Tax On First $45,282		$ 6,792
Tax On Next $41,218 ($86,500 - $45,282) At 20.5 Percent		8,450
Federal Tax Before Credits		$15,242
Basic Personal Amount	($11,474)	
Eligible Dependant - Sandy ($11,474 - $720)	(10,754)	
Family Caregiver Amount - Mark	(2,121)	
Credit Base	($24,349)	
Rate	15%	(3,652)
Federal Tax Payable		$11,590

Case 3

The solution for this Case can be completed as follows:

Tax On First $90,563		$16,075
Tax On Next $11,437 ($102,000 - $90,563) At 26 Percent		2,974
Federal Tax Before Credits		$19,049
Basic Personal Amount	($11,474)	
Eligible Dependant ($11,474 + $2,121 - $7,560)	(6,035)	
ITA 118(1)(e) Addition	(753)	
Transfer Of Son's Disability	(8,001)	
Credit Base	($26,263)	
Rate	15%	(3,939)
Federal Tax Payable		$15,110

The children's fitness and arts credits are not available since the son is over 18 years of age (the age limit if disabled).

The son qualifies for the eligible dependant credit and, because of ITA 118(4)(c), Barbra cannot claim either the infirm dependant over 17 tax credit or the caregiver tax credit. Note that the base for the eligible dependant credit includes the family caregiver amount.

In this situation, ITA 118(1)(e) provides an additional credit based on the amount that the caregiver credit would have exceeded the amount taken for the eligible dependant credit. Given the high income threshold of $15,940 for the caregiver credit, the son would qualify for the maximum amount of $6,788 ($4,667 + $2,121) which includes the FCA.

This results in a further addition to the credit base of $753 ($6,788 - $6,035).

Case 4

The solution for this Case would be as follows:

Tax On First $45,282		$ 6,792
Tax On Next $37,718 ($83,000 - $45,282) At 20.5 Percent		7,732
Federal Tax Before Credits		$14,524
Basic Personal Amount	($11,474)	
EI	(955)	
CPP	(2,544)	
Canada Employment	(1,161)	
Credit Base	($16,134)	
Rate	15%	(2,420)
Charitable Donations Including FDSC [(15%)($200) + (29%)($5,600 - $200) + (25%)($1,000)]		(1,846)
Federal Tax Payable		$10,258

Note As none of her income is taxed at 33 percent, this rate will not be applicable to the calculation of the charitable donations tax credit.

Case 5

The solution for this Case is as follows:

Tax On First $90,563		$16,075
Tax On Next $2,937 ($93,500 - $90,563) At 26 Percent		764
Federal Tax Before Credits		$16,839
Basic Personal Amount	($11,474)	
Spousal ($11,474 - $7,260)	(4,214)	
EI	(955)	
CPP	(2,544)	
Canada Employment	(1,161)	
Medical Expenses (See Note)	(9,195)	
Credit Base	($29,543)	
Rate	15%	(4,431)
Federal Tax Payable		$12,408

Note The base for the medical expense tax credit would be calculated as follows:

Barbra And Her Partner		$3,200
Reduced By The Lesser Of:		
• [(3%)($93,500)] = $2,805		
• 2016 Threshold Amount = $2,237		(2,237)
Son's Medical Expenses	$8,400	
Reduced By The Lesser Of:		
• [(3%)($5,600)] = $168		
• $2,237	(168)	8,232
Total Credit Base		$9,195

Case 6

The solution for this Case can be completed as follows:

Tax On First $45,282		$ 6,792
Tax On Next $39,318 ($84,600 - $45,282) At 20.5 Percent		8,060
Federal Tax Before Credits		$14,852
Basic Personal Amount	($11,474)	
Spousal ($11,474 - $7,200)	(4,274)	
Caregiver Including FCA - John's Father ($4,667 + $2,121)	(6,788)	
Caregiver - Barbra's Father [$4,667 - ($19,400 - $15,940)]	(1,207)	
EI	(955)	
CPP	(2,544)	
Canada Employment	(1,161)	
Credit Base	($ 28,403)	
Rate	15%	(4,260)
Federal Tax Payable		$10,592

Both fathers qualify for the caregiver credit. In the case of John's father, because he is infirm, the family caregiver amount is added to the credit. In the case of Barbra's father, the family caregiver amount is not added and the basic credit is eroded by the parent's income in excess of the income threshold.

Case 7

The solution for this Case can be completed as follows:

Tax On First $140,388		$29,029
Tax On Next $22,612 ($163,000 - $140,388) At 29 Percent		6,557
Federal Tax Before Credits		$35,586
Basic Personal Amount	($11,474)	
Spousal ($11,474 - $7,240)	(4,234)	
Caregiver Including FCA - Son ($4,667 + $2,121)	(6,788)	
EI	(955)	
CPP	(2,544)	
Canada Employment	(1,161)	
Transfer From Son (Note)	(5,000)	
Credit Base	($32,156)	
Rate	15%	(4,823)
Federal Tax Payable		$30,763

Note The son qualifies for both the caregiver tax credit and the infirm dependant over 17 tax credit. In these circumstances, ITA 118(4)(d) effectively requires the use of the caregiver credit. As the son is infirm, the family caregiver amount is added to this credit. Since the son's income is below the income threshold of the caregiver tax credit, the full credit is available. The transfer from the son is as follows:

Tuition Fees	$ 8,300
Base For Education Credit [(8 Months)($400)]	3,200
Base For Textbook Credit [(8 Months)($65)]	520
Total Amount Available	$12,020
Maximum Transfer	(5,000)
Carry Forward (For Son's Use Only)	$ 7,020

The son's Tax Payable is completely eliminated by his basic personal credit. He can transfer a maximum of $5,000 of his education, tuition and textbook amounts to his mother. The remaining $7,020 can be carried forward indefinitely, but must be used by the son.

TIF Solution Four - 8

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

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

Basic Personal Amount	$11,474
Total Credit Base	$11,474
Rate	15%
Total Credits	$ 1,721

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

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

Basic Personal Amount	$11,474
Spousal	Nil
EI (Maximum)	955
CPP (Maximum)	2,544
Canada Employment	1,161
Total Credit Base	$16,133
Rate	15%
Total Credits	$ 2,420

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

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

Basic Personal Amount	$11,474
Spousal ($11,474 - $1,500)	9,974
Total Credit Base	$21,448
Rate	15%
Total Credits	$ 3,217

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

Basic Personal Amount	$11,474
Spousal ($11,474 - $1,200)	10,274
Total Credit Base	$21,748
Rate	15%
Total Credits	$ 3,262

There is no personal tax credit available for his son.

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

Basic Personal Amount	$11,474
Eligible Dependant ($11,474 - $720) (See Note)	10,754
Total Credit Base	$22,228
Rate	15%
Total Credits	$ 3,334

Note The eligible dependant credit can be taken for either child. As Ms. Morrison has elected to allocate the Universal Child Care Benefits to her eligible dependant, the base for this credit must be reduced by the UCCB received.

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

Basic Personal Amount	$11,474
Spousal Including FCA ($11,474 + $2,121)	13,595
Age	7,125
Pension	2,000
Spouse's Disability	8,001
Total Credit Base	$42,195
Rate	15%
Total Credits	$ 6,329

As Mr. Bagley's Net Income For Tax Purposes is less than the relevant income thresholds, there will be no reduction in his age credit or clawback of his OAS payments. Note that, because his wife is blind, the family caregiver amount is added to the spousal credit.

TIF Solution Four - 9

The federal Tax Before Credits is the same in all five of the cases in this problem. It is calculated as follows:

Tax On First $45,282	$ 6,792
Tax On Next $14,718 ($60,000 - $45,282) At 20.5 Percent	3,017
Tax Before Credits	$9,809

Case A

The solution to this Case can be completed as follows:

Tax Before Credits		$9,809
Basic Personal Amount	($11,474)	
Spousal ($11,474 - $8,800)	(2,674)	
EI	(955)	
CPP	(2,544)	
Canada Employment	(1,161)	
Caregiver [$4,667 - ($16,000 - $15,940)]	(4,607)	
Credit Base	($23,415)	
Rate	15%	(3,512)
Federal Tax Payable		$ 6,297

As Bernice is a parent over 64 years of age, she does not have to be infirm to qualify for the caregiver credit. Mr. Norris would make the claim since Susan would have no Tax Payable. Note that because Bernice is not mentally or physically infirm, the family caregiver amount is not added to the caregiver credit.

Case B

The solution to this Case can be completed as follows:

Tax Before Credits			$9,809
Basic Personal Amount		($11,474)	
Spousal ($11,474 - $4,410)		(7,064)	
EI		(955)	
CPP		(2,544)	
Canada Employment		(1,161)	
Medical Expenses	($3,150)		
Reduced By The Lesser Of:			
• [(3%)($60,000)] = $1,800			
• 2016 Threshold Amount = $2,237	1,800	(1,350)	
Credit Base		($24,548)	
Rate		15%	(3,682)
Federal Tax Payable			$ 6,127

Case C

The solution to this Case can be completed as follows:

Tax Before Credits		$9,809
Basic Personal Amount	($11,474)	
Spousal ($11,474 - $4,500)	(6,974)	
EI	(955)	
CPP	(2,544)	
Canada Employment	(1,161)	
Transfer From Son (Note)	(5,000)	
Credit Base	($28,108)	
Rate	15%	(4,216)
Federal Tax Payable		$ 5,593

Note: The transfer from the son is as follows:

Tuition Fees	$ 9,000
Base For Education Credit [(8 Months)($400)]	3,200
Base For Textbook Credit [(8 Months)($65)]	520
Total Amount Available	$12,720
Maximum Transfer	(5,000)
Carry Forward (For Allen's Use Only)	$ 7,720

Allen's Tax Payable is completely eliminated by his basic personal credit. He can transfer a maximum of $5,000 of his education, tuition and textbook amounts to his father. The remaining $7,720 can be carried forward indefinitely, but must be used by Allen.

Case D

The solution to this Case can be completed as follows:

Tax Before Credits		$9,809
Basic Personal Amount	($11,474)	
EI	(955)	
CPP	(2,544)	
Canada Employment	(1,161)	
Credit Base	($16,134)	
Rate	15%	(2,420)
Political Contributions Tax Credit [(3/4)($400) + (1/2)($350) + (1/3)($250)]		(558)
Charitable Donations [(15%)($200) + (29%)($15,000 - $200)]		(4,322)
Federal Tax Payable		$ 2,509

As none of his income is taxed at 33 percent, this rate will not be applicable to the calculation of the charitable donations tax credit.

Unused charitable donations can be carried forward for up to five years. The limitation of 75 percent of Net Income For Tax Purposes would have given Mr. Norris a maximum credit based on $38,250 [(75%)($51,000)] in charitable donations. However, if he chose that amount, the credit would be larger than his Tax Payable. Because this is a non-refundable credit, he should not use an amount of the contribution that would create a credit larger than his tax otherwise payable.

This leaves Mr. Norris with $35,000 ($50,000 - $15,000) in charitable donations that can be carried forward for five years. He will be subject to the 75 percent limitation of Net Income For Tax Purposes in any year he claims the charitable donations.

Case E

The solution to this Case can be completed as follows:

Tax Before Credits		$9,809
Basic Personal Amount	($11,474)	
Eligible Dependant - Mary ($11,474 - $360)	(11,114)	
EI	(955)	
CPP	(2,544)	
Canada Employment	(1,161)	
Interest On Student Loan	(450)	
Credit Base	($27,698)	
Rate	15%	(4,155)
Federal Tax Payable		$ 5,654

TIF Solution Four - 10

Mr. Brooks' minimum Net Income For Tax Purposes for the year would be calculated as follows:

Gross Salary	$63,000
Additions:	
Bonus (Amount Received Only)	$6,500
Disability Insurance Receipts (Note 1)	4,200
Personal Benefit On Car (Note 2	1,034
Stock Option Benefit [($28 - $23)(200)]	1,000
Home Relocation Loan Benefit (Note 3)	625
Deductions:	
RPP Contributions	(2,800)
Union Dues	(240)
Net Income For Tax Purposes	$73,319

Note 1 As all of the premiums were paid by the employer and were not considered to be a taxable benefit, benefits received under this coverage must be included in employment income.

Note 2 The personal benefit on the company car, taking into consideration the two months he was in the hospital and unable to make use of the car, would be as follows:

Standby Charge [(2/3)(10)($678)(5,000/16,670)*]	$1,356
Operating Cost Benefit - Lesser Of:	
• [(5,000)($0.26)] = $1,300	
• [(1/2)($1,356)] = $678	678
Less: Payments Withheld By Employer	(1,000)
Taxable Benefit	$1,034

*[(10)(1,667)]

Note 3 The taxable benefit associated with the home relocation loan would be calculated as follows:

[($125,000)(2% - Nil)(3/12)] = $625

Taxable Income

Mr. Brooks' Taxable Income would be calculated as follows:

Net Income For Tax Purposes	$73,319
Stock Option Deduction [(1/2)($1,000)]	(500)
Home Relocation Loan Deduction - Lesser Of:	
• Benefit Included In Income = $625	
• [($25,000)(2% - Nil)(3/12)] = $125	(125)
Taxable Income	$72,694

Tax Payable

Mr. Brooks' federal Tax Payable (Refund) would be calculated as follows:

Tax On First $45,282		$ 6,792
Tax On Next $27,412 ($72,694 - $45,282) At 20.5 Percent		5,619
Federal Tax Before Credits		$12,411
Basic Personal Amount	($11,474)	
Eligible Dependant Including FCA - Harold ($11,474 + $2,121 - $360) (Note 4)	(13,235)	
Transfer Of Harold's Disability	(8,001)	
Harold's Disability Supplement	(4,667)	
Caregiver - Mother (Note 5)	(4,667)	
EI Premiums	(955)	
CPP Contributions	(2,544)	
Canada Employment	(1,161)	
Public Transit Passes (Note 6)	(860)	
Medical Expenses (Note 7)	(10,590)	
Tuition Fee - Unreimbursed Music Course (Note 8)	(600)	
First Time Home Buyer's	(5,000)	
Credit Base	($63,754)	
Rate	15%	(9,563)
Charitable Donations (Note 9) [(15%)($200) + (29%)($480 - $200)]		(111)
Net Federal Tax		$ 2,737
Federal Income Tax Withheld		(3,000)
Federal Tax Payable (Refund)		($ 263)

Note 4 Harold qualifies for the family caregiver amount. The Universal Child Care Benefit has reduced the base for the eligible dependant credit.

Note 5 Mr. Brooks is eligible for the caregiver credit for his mother as she is over 64 years of age and her income is below the threshold for the caregiver credit. This means that Mr. Brooks can claim the full amount of the caregiver credit. As she is not infirm, the family caregiver amount is not available for her.

Note 6 Mr. Brooks cannot claim the cost of the transit passes for his mother. As a result, the base for the public transit pass credit is $860 [(10)($26 + $60)].

Note 7 Allowable medical expenses are as follows:

Mr. Brooks' And Minor Child (Harold) Medical Expenses ($9,300 + $2,450)		$11,750
Reduced By The Lesser Of:		
• [(3%)($73,319)] = $2,200		
• 2016 Threshold Amount = $2,237		(2,200)
Grace's Medical Expenses	$1,265	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)($7,500)] = $225	(225)	1,040
Allowable Medical Expenses		$10,590

Note 8 Since the music course was less than three consecutive weeks in duration, Mr. Brooks cannot claim the education or textbook credit for that course. As the accounting course tuition fees were reimbursed by his employer, no education or textbook credits are available for that course either.

Note 9 As none of his income is taxed at 33 percent, this rate will not be applicable to the calculation of the charitable donations tax credit.

TIF Solution Four - 11

Part A - Net Income For Tax Purposes

Marvin's minimum Net Income For Tax Purposes would be calculated as follows:

Salary	$112,468
Additions:	
Bonus (Amounts Received After 2019 - Salary Deferral Arrangement)	20,000
Automobile Benefit (Note 1)	991
Stock Options (Note 2)	3,900
Gifts (Note 3)	1,800
Client Meals And Entertainment (Note 4)	Nil
Interest Free Loan Benefit (Note 5)	3,000
Deductions:	
RPP Contributions	(6,800)
Professional Association Dues	(3,400)
Net Income For Tax Purposes	$131,959

Note 1 The automobile benefit would be calculated as follows:

Standby Charge [(2/3)(10)($456 - $43)(4,000 ÷ 16,670*)]	$661
Operating Cost Benefit - Lesser Of:	
• [(1/2)($661)] = $330	
• [($0.26)(4,000)] = $1,040	330
Total Benefits	$991

*[(10)(1,667)]

As Marvin's employment related use was more than 50 percent, the reduced standby charge is available. In addition, he can use the alternative calculation of the operating cost benefit.

Note 2 The stock option benefit would be calculated as follows:

[(300)($85 - $72)] = $3,900

Note 3 The $1,200 Employee Of The Month Award is performance related and would be a taxable benefit. Also a taxable benefit would be the $600 gift certificate as it is a near cash gift. The Christmas basket is under the $500 limit and would not be a taxable benefit. The total taxable benefit would be $1,800 ($1,200 + $600).

Note 4 Marvin's meal and entertainment costs exceed his employer's reimbursement by the $1,000 that were not reimbursed. However, as he has no commission income, he cannot deduct these out-of-pocket costs.

Note 5 The taxable benefit on the loan is calculated as follows:

[(2%)($200,000)(9/12)] = $3,000

Part B - Taxable Income

Since the loan was not a home relocation loan, there is no deduction from Taxable Income available. Marvin's Taxable Income would be calculated as follows:

Net Income For Tax Purposes	$131,959
Stock Option Deduction [(1/2)($3,900)]	(1,950)
Taxable Income	$130,009

Part C - Tax Payable

Based on the Taxable Income calculated in Part B, Marvin's Tax Payable would be calculated as follows:

Tax On First $90,563		$16,075
Tax On Next $39,446 ($130,009 - $90,563) At 26 Percent		10,256
Tax Before Credits		$26,331
Non-Refundable Credits Other Than Donations:		
Basic Personal Amount	($11,474)	
Spousal Including FCA ($11,474 + $2,121 - $8,460)	(5,135)	
Caregiver Including FCA - Suzanne (Note 6)	(6,788)	
Transfer Of Leslie's Disability	(8,001)	
Transfer Of Samantha's Education Related Credits (Note 7)	(3,674)	
First Time Home Buyers (Maximum)	(5,000)	
EI Premiums	(955)	
CPP Contributions	(2,544)	
Canada Employment	(1,161)	
Medical Expenses (Note 8)	(17,261)	
Credit Base	($61,993)	
Rate	15%	(9,299)
Charitable Donations Including FDSC (Note 9)		(947)
Marvin's Federal Tax Payable		$16,085

Note 6 Suzanne is eligible for both the infirm dependant over 17 and the caregiver tax credits. In these circumstances, ITA 118(4)(d), in effect, requires the use of the caregiver credit. Because Suzanne is infirm, and her income is below the threshold for the caregiver credit, Marvin can claim the full amount of the caregiver credit, as well as the family caregiver amount.

Note 7 Samantha's total education related amounts are calculated as follows:

Tuition	$10,300
Education [(11)($400)]	4,400
Textbook [(11)($65)]	715
Total	$15,415

Samantha will have to reduce her own Tax Payable to nil before transferring any credits. She will require $1,326 [$12,800 - $11,474] of this amount. This means that his transfer will be limited to $3,674 ($5,000 - $1,326). This will leave Samantha with a carry forward of $10,415 ($15,415 - $5,000).

Note 8 It would appear that the rhinoplasty surgery for Samantha is purely cosmetic in nature. As a consequence, it is not an eligible medical expense. Sharon's rhinoplasty surgery appears to be medically required and would be allowable. The base for Marvin's medical expense credit can be calculated as follows:

Marvin, Leslie, And Sharon ($2,200 + $3,100)		$ 5,300
Reduced By The Lesser Of:		
• [(3%)($131,959)] = $3,959		
• 2016 Threshold Amount = $2,237		(2,237)
Suzanne's Medical Expenses	$12,300	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)($7,250)] = $218	(218)	12,082
Samantha's Allowable Medical Expenses ($16,000 - $13,500)	$2,500	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)($12,800)] = $384	(384)	2,116
Allowable Medical Costs		$17,261

Note 9 Given this, the credit is equal to $947 [(15%)($200) + (29%)($2,500 - $200) + (25%)($1,000)]

Note 10 While the cost of the martial arts program would be a qualified fitness expenditure, Sharon is 17 and healthy. Given this, she does not qualify for the fitness credit.

TIF Solution Four - 12

Part A

Martin's minimum Net Income For Tax Purposes would be calculated as follows:

Salary	$ 98,500
Additions:	
Bonus (2016 Receipt)	3,000
Bonus (Amounts After 2019 - Salary Deferral)	3,000
Client Meals And Entertainment (Note 1)	Nil
Stock Options (Note 2)	12,500
Interest Free Loan Benefit (Note 3)	1,400
Automobile Benefit (Note 4)	8,825
Gifts (Note 5)	550
Deductions:	
RPP Contributions	(4,300)
Union Dues	(450)
Net Income For Tax Purposes	$123,025

Note 1 Martin's meal and entertainment costs exceed his employer's reimbursement by $5,000 ($12,300 - $7,300). However, as he has no commission income, he cannot deduct these out-of-pocket costs.

Note 2 The stock option benefit would be calculated as follows:

[(500)($70 - $45)] = $12,500

Note that, because the option price was less than the fair market value of the shares at the time the options were granted, no ITA 110(1)(d) deduction is available in the determination of Taxable Income (Part B).

Note 3 The loan does not qualify as a home relocation loan. The taxable benefit on the loan is calculated as follows:

[(1%)($280,000)(6/12)] = $1,400

Note 4 The automobile benefit would be calculated as follows:

Standby Charge [(2%)(11)($45,200)(11,000 ÷ 18,337*)]	$5,965
Operating Cost Benefit - Lesser Of:	
• [(1/2)($5,965)] = $2,983	
• [($0.26)(11,000)] = $2,860	2,860
Total Benefits	$8,825

*[(11)(1,667)]

As Martin's employment related use was more than 50 percent, the reduced standby charge is available. In addition, he could use the alternative calculation of the operating cost benefit. However, it does not provide the lower figure in this case.

Note 5 The gift certificate for $250 is taxable because it is a near-cash gift. The first $500 of the long-service award will not be a taxable benefit. However, the excess of $300 ($800 - $500) will be a taxable benefit. As the value of the Christmas gift basket is under $500, it will not create a taxable benefit. The total taxable benefit for gifts is $550 ($250 + $300).

Part B

Martin's Taxable Income would be equal to his Net Income For Tax Purposes as there is no stock option deduction or home relocation loan deduction available.

Part C

Based on the Taxable Income calculated in Part B, Martin's Tax Payable would be calculated as follows:

Tax On First $90,563		$16,075
Tax On Next $32,462 ($123,025 - $90,563) At 26 Percent		8,440
Tax Before Credits		$24,515
Credits:		
Basic Personal Amount	($11,474)	
Spousal Including FCA ($11,474 + $2,121 - $9,400)	(4,195)	
Caregiver Including FCA - Devon (Note 6)	(6,788)	
Transfer Of Brian's Disability	(8,001)	
Transfer Of Derek's Education Related Credits (Note 7)	(3,824)	
First Time Home Buyers (Maximum)	(5,000)	
Transit Passes [($85)(1)(10)] (Note 8)	(850)	
EI Premiums	(955)	
CPP Contributions	(2,544)	
Canada Employment	(1,161)	
Medical Expenses (Note 9)	(16,203)	
Credit Base	($60,995)	
Rate	15%	(9,149)
Charitable Donations (Note 10)		(552)
Federal Tax Payable		$14,814
Federal Tax Withheld		(18,000)
Amount Owing (Refund)		($ 3,186)

Note 6 Devon is eligible for both the infirm dependant over 17 and the caregiver tax credits. In these circumstances, ITA 118(4)(d), in effect, requires the use of the caregiver credit. Because Devon is infirm, and his income is below the threshold for the caregiver credit, Martin can claim the full amount of the caregiver credit, as well as the family caregiver amount.

Note 7 Derek's total education related amounts are calculated as follows:

Tuition	$10,300
Education [(8)($400)]	3,200
Textbook [(8)($65)]	520
Total	$14,020

Derek will have to reduce his own Tax Payable to nil before transferring any credits. He will require $1,176 [$13,500 - $11,474 - ($85)(10)] of this amount. This means that his transfer will be limited to $3,824 ($5,000 - $1,176). This will leave Derek with a carry forward of $9,020 ($14,020 - $5,000). Note that, because he is over 18, he must claim the transit pass credit even though the passes were paid for by Martin.

The reason for the assumption of no CPP contributions is that business income is not covered until Chapter 6. Derek's self-employed income would be reduced by half of the CPP paid and his tax payable would be reduced by the other half.

Note 8 The transit pass credit can only be claimed for children who have not attained the age of 19 during the year. Although he has paid for them, Martin cannot claim Derek's transit passes. Derek has claimed them in the Note 7 calculation.

Note 9 The base for Martin's medical expense credit can be calculated as follows:

Martin, Brian, And David ($2,200 + $1,700)		$ 3,900
Reduced By The Lesser Of:		
• [(3%)($123,025)] = $3,691		
• 2016 Threshold Amount = $2,237		(2,237)
Devon's Medical Expenses	$10,600	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)($5,150)] = $155	(155)	10,445
Derek's Medical Expenses	$4,500	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)($13,500)] = $405	(405)	4,095
Allowable Medical Costs		$16,203

Note 10 As Martin's Taxable Income does not exceed $200,000, the 33 percent rate is not applicable in calculating the charitable donations tax credit. Given this, his charitable donations tax credit is $552 [(15%)($200) + (29%)($2,000 - $200)].

TIF Solution Four - 13

Part A

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

Salary	$143,000
Additions:	
Bonus [(2/3)($34,500)]	23,000
Automobile Benefit (Note 1)	6,101
Client Meals And Entertainment (Note 2)	Nil
Interest Free Loan Benefit (Note 3)	1,250
Gifts (Note 4)	1,100
Stock Options (Note 5)	9,600
Deductions:	
RPP Contributions	(6,400)
Professional Association Dues	(1,200)
Net Income For Tax Purposes	$176,451

Note 1 The automobile benefit would be calculated as follows:

Standby Charge [(2/3)(11)($728 - $50)(15,000 ÷ 18,337*)]	$4,067
Operating Cost Benefit - Lesser Of:	
• [(1/2)($4,067)] = $2,034	
• [($0.26)(15,000)] = $3,900	2,034
Total Benefits	$6,101

*[(11)(1,667)]

As Ms. Dalvi's employment related use was more than 50 percent, the reduced standby charge is available. In addition, she can use the alternative calculation of the operating cost benefit.

Note 2 Ms. Dalvi's meal and entertainment costs exceed her employer's reimbursement by $5,300 ($14,800 - $9,500). However, as she has no commission income, she cannot deduct these out-of-pocket costs.

Note 3 As there has been no change in the prescribed rate, the taxable benefit on the loan is calculated as follows:

[(1%)($250,000)(6/12)] = $1,250

Note 4 The gift certificate for $400 is taxable because it is a near-cash gift. The first $500 of the long-service award will not be a taxable benefit. However, the excess of $700 ($1,200 - $500) will be a taxable benefit. As the value of the Christmas gift basket is under $500, it will not create a taxable benefit. The total taxable benefit is $1,100 ($400 + $700).

Note 5 The stock option benefit would be calculated as follows:

[(1,200)($45 - $37)] = $9,600

Note that, because the option price was less than the fair market value of the shares at the time the options were granted, no ITA 110(1)(d) deduction is available in the determination of Taxable Income (Part B).

Part B

Ms. Dalvi's Taxable Income would be equal to her Net Income For Tax Purposes as there is no stock option deduction or home relocation loan deduction available.

Part C

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

Tax On First $140,388		$ 29,029
Tax On Next $36,063 ($176,451 - $140,388) At 29 Percent		10,458
Tax Before Credits		$39,487
Credits:		
Basic Personal Amount	($11,474)	
Spousal Including FCA ($11,474 + $2,121 - $7,200)	(6,395)	
Caregiver Including FCA - Mary (Note 6)	(6,788)	
EI Premiums	(955)	
CPP Contributions	(2,544)	
Canada Employment	(1,161)	
Spouse's Age	(7,125)	
Spouse's Disability	(8,001)	
First Time Home Buyers (Maximum)	(5,000)	
Transfer Of Mark's Education Related Credits (Note 7)	(5,000)	
Transit Passes [($75)(1)(10)] (Note 8)	(750)	
Medical Expenses (Note 9)	(19,419)	
Credit Base	($74,612)	
Rate	15%	(11,192)
Charitable Donations (Note 10)		(1,132)
Federal Tax Payable		$27,163
Federal Tax Withheld		(29,000)
Amount Owing (Refund)		($ 1,837)

Note 6 Mary is eligible for both the infirm dependant over 17 and the caregiver tax credits. In these circumstances, ITA 118(4)(d), in effect, requires the use of the caregiver credit. Because Mary is infirm, and her income is below the threshold for the caregiver credit, Ms. Dalvi can claim the full amount of the caregiver credit, as well as the family caregiver amount.

Note 7 Mark's total education related amounts are calculated as follows:

Tuition	$ 9,400
Education [(10)($400)]	4,000
Textbook [(10)($65)]	650
Total	$14,050

As Mark has no income of his own, he cannot use any of these amounts. However, the transfer to his mother is limited to $5,000, leaving him with a carry forward to subsequent years of $9,050 ($14,050 - $5,000).

Note 8 The transit pass credit can only be claimed for children who have not attained the age of 19 during the year. Ms. Dalvi cannot claim Mark's transit passes.

Note 9 The base for Ms. Dalvi's medical expense credit can be calculated as follows:

Ms. Dalvi, Her Spouse And Minor Child ($6,200 + $1,800)		$ 8,000
Reduced By The Lesser Of:		
• [(3%)($176,451)] = $5,294		
• 2016 Threshold Amount = $2,237		(2,237)
Mary's Medical Expenses	$11,300	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)($4,800)] = $144	(144)	11,156
Mark's Medical Expenses	$2,500	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)(Nil)] = Nil	(Nil)	2,500
Allowable Medical Costs		$19,419

Note 10 As Margarita's Taxable Income does not exceed $200,000, the 33 percent rate is not applicable in calculating the charitable donations tax credit. Given this, the credit is equal to $1,132 [(15%)($200) + (29%)($4,000 - $200)].

Chapter Five Test Item File Solutions

TIF Solution Five - 1

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

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

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

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

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

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

   Government Assistance Under the provisions of ITA 13(7.1), government grants to assist in the acquisition of capital assets must be deducted from the capital cost of the assets acquired. Under IAS 20, *Accounting For Government Grants And Disclosure Of Government Assistance*, such assistance can either be deducted as per the tax procedures or treated as a deferred charge.

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

3. The examples that are listed in the text are as follows:
   - Separate businesses must have separate Classes for each business.
   - Each rental property with a cost of more than $50,000 must be allocated to a separate class.
   - Each passenger vehicle with a cost in excess of $30,000 must be allocated to a separate class.

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

5. The CCA rate applicable to a particular type of asset can be changed by either changing the rate for the class where the type of asset is allocated, or by allocating that type of asset to a different class that has the desired new rate. In general, the latter approach is preferable for two reasons:
   - As most classes contain a variety of asset types, changing the rate for the class will change the rate for assets other than the type on which the rate change is desired.
   - Changing the rate for the class will require the new rate to be used on all of the assets in the class, including assets that were acquired prior to the change. This type of retroactive change is thought by many to be unfair, in that taxpayers made various economic decisions based on the applicability of the old rate.

6. The differences are as follows:
   - The addition to Class 10.1 is limited to $30,000, without regard to the actual cost of the vehicle. There is no similar limit on Class 10 additions.
   - In the year of disposal, one-half the normal CCA can be taken on Class 10.1 vehicles. Class 10 vehicles are subject to the usual disposal rules, with CCA available on any balance remaining in the Class.
   - In the year of retirement, no recapture or terminal loss can be recognized on Class 10.1 vehicles. Class 10 vehicle retirements may result in recapture or terminal losses.

7. The election could be useful if the patent is acquired near the end of its legal life. For example, if only three years remained, the annual write off would be one-third of the cost, resulting in larger deductions than would be the case using Class 44's 25 percent declining balance rate.

8. The exceptions that are listed in the text are as follows:
   - All of the assets that are allocated to Class 14
   - Some of the assets that are allocated to Class 12 (e.g., tools costing less than $500).
   - Assets acquired from a non-arm's length taxpayer, provided the assets were being used by that taxpayer to produce business or property income.

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

10. As listed in the text, the conditions are as follows:

    - The proceeds of disposition are less than the capital cost of the asset.
    - There are additional assets in the CCA Class.
    - There is a positive balance in the CCA Class, subsequent to the subtraction of the proceeds of disposition. Even if the balance is negative at the time of the disposition, there will still be no tax consequences, provided additions to the Class prior to the end of the year leave a positive balance.

11. With respect to recapture of CCA, this will arise if there is a negative balance in a CCA class at the end of a taxation year. Such recapture will arise whether there are still assets in the class or, alternatively, no assets remain in the class

    A terminal loss arises only when there are no assets left in a class at the end of the taxation year and a positive UCC balance remains in that class.

12. With respect to recapture of CCA, the negative balance in the class must be added to Net Income For Tax Purposes, In addition, it must be added to the UCC balance in order to restore it to nil at the beginning of the next taxation year.

    When there is a terminal loss, 100 percent of this balance must be subtracted from Net Income For Tax Purposes. In addition, it must be deducted from the UCC balance in order to restore it to nil at the beginning of the next taxation year.

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

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

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

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

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

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

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

16. The maximum CCA deduction is calculated using a variety of rates applied to the balances in different CCA classes. These rates are applied either on a declining balance basis or, alternatively, on a straight line basis. In addition, most CCA classes are subject to the half-year rule, which requires the deduction of one-half of the net additions from the UCC balance prior to calculating maximum CCA.

    In contrast, the maximum CEC deduction is calculated using a single rate. This rate is specified in the *Income Tax Act* as 7 percent. This rate is only applied to the declining balance in the CEC account. The half-year rule is not applicable to this calculation.

17. When there is a disposal of CEC, three-quarters of the proceeds of disposition is subtracted from the CEC balance. If a positive balance remains, the enterprise would continue to calculate a CEC amount at the rate of 7 percent. Unless the business is being terminated, no loss would be recognized.

    If the subtraction of three-quarters of the proceeds of disposition results in a negative balance, there will be an income inclusion. To the extent that there have been CEC deductions in the past, the negative amount will be added to income under ITA 14(1). This is the equivalent of recapture for depreciable assets.

    Any excess of the negative amount over past CEC deductions will be viewed as similar to a capital gain. To give this excess amount treatment analogous to that given to capital gains, it will be multiplied by two-thirds prior to its inclusion in the taxpayer's income. This factor reduces the amount from a three-quarters inclusion to a one-half inclusion [(3/4)(2/3) = 1/2].

TIF Solution Five - 2

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

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

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

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

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

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

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

8. False. Taxpayers can deduct 100 percent of terminal losses in the determination of Net Income For Tax Purposes.

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

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

TIF Solution Five - 3

New For 2016/2017

CCA Question

1. B. Amortization And Capital Cost Allowance.

2. D. Class 8. At 20 percent, this Class has the lowest rate for calculating CCA.

3. B. The business will have recapture of $75,439 ($450,000 - $374,562) and a capital gain of $281,000 ($843,000 - $562,000).

4. D. A terminal loss occurs when there are no assets left in the Class and there is a negative balance in the Class at the end of the year.

5. C. [(3/4)($60,000)(7%)] = $3,150; [($45,000 - $3,150) - (75%)($82,000)] = ($19,650) [$3,150 + (2/3)($19,650 - $3,150)] = $14,150.

6. A. If a disposition creates a negative balance in the cumulative eligible capital account at the end of the year, 100 percent of the negative amount must be taken into income.

7. F. $18,000 [20%[$80,000 + (1/2)($20,000]

8. K. $60,800 [$80,000 - $4,000 - (20%)($80,000 - $4,000)].

9. E. $13,000 [(20%)($80,000 - $15,000)].

10. J. $52,000 [$80,000 - $15,000 - (20%)($80,000 - $15,000)].

11. B. $10,000 [(20%)($80,000 - $90,000 + $60,000)].

12. Q. Recapture of $5,000. ($80,000 – 85,000)

13. T. $10,000 terminal loss. ($80,000 – 70,000)

14. W. $5,000 taxable capital gain. ($50,000 – 40,000) x 50%

15. G. $19,000 [20%][$80,000 - $70,000 + $100,000 - (½)($100,000 - $70,000)].

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

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

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

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

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

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

22. B. The equipment falls under Class 8, with CCA of 20%. Taking into account the half-year rule and the short fiscal year, the CCA is $1,336.99 [($40,000)(20%)(½)(122/365)].

23. A. Robert has recapture of $44,000 [($320,000 - $80,000) - $196,000]. The capital gain on the sale of the total property is $200,000 ($520,000 - $320,000) which makes D wrong.

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

25. B. $1,050 ($8,000/10) + ($4,500/9 x 50%) = $1,050

26. C. $5,000 for 2014; $10,000 for 2015; $5,000 for 2016 (straight-line over 2 years, half year rule)

27. D. $1,500 decrease

28. B. $640 ($1,600 x 55% x 50%) + ($400 x 100% x 50%) = $640

29. A. $4,500 ($30,000 maximum x 30% x 50%) = $4,500

30. C. CCA deduction of $2,678 ($17,850 x 30% x 50%)

31. B. $12,500 ($250,000 x 4% x 50%) + ($250,000 x 6% x 50%) = $12,500

32. D. $880 Class 8 ($600 x 20% x 50%) + Class 12 ($350 + 470) x 100% = $880

33. C. $10,300 - 1,000 = $9,300. CCA is not deducted until the start of the following year.

34. A Recapture occurs when there is a negative UCC balance in a class, even if there are assets remaining in the class.

35. C. A delivery truck is leased during the year on a 3 year lease.

36. A. $75,000/10 = $7,500 CCA annually. Pro-rate for days owned in the year: 30/365 × $7,500 = $616

37. D. [($12,900)(30%)(1/2)] = $1,935

38. C. [($4,000)(100%)(½)] = $2,000

39. B. $37,061 $50,000 x 75% - ($50,000 x 75% x 7% x 61/365) = $37.061

40. C. $2,050
2015 CEC deduction = $20,000 x 75% x 7% = $1,050
CEC Balance = ($20,000 x 75%) - $1,050 - ($22,000 x 75%) = ($2,550)
Increase In Income = [(2/3)($2,550 - $1,050) + $1,050]

41. B. $139 [$6,487 – ($6,000 x 75%)] x 7%

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

43. C. [($200,000)(3/4)(7%) = $10,500

TIF Solution Five - 4

Exam Exercise Solution Five - 1 (Segregation Into Classes)

The correct classes for each of the assets would be as follows:

Asset	Class
Cash registers	8
Boats, canoes, and other vessels	7
Airplane runways	17
Passenger vehicle with a cost of $85,000*	10.1
Power operated moveable equipment	38
Storage tanks for oil	6
Rental building*	1
Manufacturing and processing equipment	53

*These two assets would have to be allocated to separate classes. In addition, as covered later in the Chapter, the taxpayer could elect to include the photocopy machine in a separate class if its capital cost is $1,000 or more.

Exam Exercise Solution Five - 2 (CCA Error)

The impact can be calculated as follows:

Correct CCA [($437,000)(1/2)(20%)]	$43,700
CCA Taken [($437,000)(1/2)(4%)]	(8,740)
Understatement Of CCA	$34,960

Exam Exercise Solution Five - 3 (CCA/CEC Error)

The impact can be calculated as follows:

Correct CEC Amount [(7%)(3/4)($675,000)]	$35,438
CCA Deducted [(20%)(1/2)($675,000)]	(67,500)
Overstatement Of Deductions	($32,062)

Exam Exercise Solution Five - 4 (Class 13 And Half-Year Rule)

The required CCA calculations would be as follows:

On 2010 Improvements ($112,000 ÷ 10)	$11,200
On 2016 Improvements [($41,000 ÷ 4)(1/2)]	5,125
2016 Capital Cost Allowance	$16,325

Exam Exercise Solution Five - 5 (Class 10 And Half-Year Rule)

The maximum 2016 CCA of $139,875 and the January 1, 2017 UCC balance of $339,625 would be calculated as follows:

January 1, 2016 UCC Balance		$453,000
Add: Additions	$63,200	
Deduct: Dispositions - Given	(36,700)	26,500
Deduct: One-Half Net Additions [(1/2)($26,500)]		(13,250)
CCA Base		$466,250
CCA [(30%)($466,250)]		(139,875)
Add: One-Half Net Additions		13,250
January 1, 2017 UCC Balance		$339,625

Exam Exercise Solution Five - 6 (Class 8 And Half-Year Rule)

The maximum 2016 CCA of $25,980 and the January 1, 2017 UCC balance of $105,320 would be calculated as follows:

January 1, 2016 UCC Balance		$128,500
Add: Additions	$12,400	
Deduct: Dispositions - Lesser Of:		
• Cost = $9,600		
• Proceeds Of Disposition = $10,200	(9,600)	2,800
Deduct: One-Half Net Additions [(1/2)($2,800)]		(1,400)
CCA Base		$129,900
CCA [(20%)($129,900)]		(25,980)
Add: One-Half Net Additions		1,400
January 1, 2017 UCC Balance		$105,320

Exam Exercise Solution Five - 7 (Class 14 - No Half Year Rule)

Limited life franchises are allocated to Class 14. While the half year rule is not applicable to this Class, CCA is based on the number of days in the year that the asset is used. In this case the maximum 2016 CCA would be $4,858 [($286,000 ÷ 5)(31 ÷ 365)]. The January 1, 2017 UCC balance would be $281,142 ($286,000 - $4,858).

Exam Exercise Solution Five - 8 (Short Fiscal Periods)

The maximum CCA for the year is $9,432 [(30%)(1/2)($150,000)(153/365)].

Exam Exercise Solution Five - 9 (Short Fiscal Periods)

The maximum CCA for the year is $6,202 [(20%)(1/2)($92,400)(245/365)].

Exam Exercise Solution Five - 10 (CCA And Tax Planning)

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

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

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

Exam Exercise Solution Five - 11 (CCA And Tax Planning)

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

Required Total		$14,000
Maximum CCA - Class 1 [(4%)($213,000)]	($8,520)	
Maximum CCA - Class 8 [(20%)($16,000)]	(3,200)	(11,720)
Required Balance		$ 2,280

The remaining $2,280 would be deducted from Class 10.

Exam Exercise Solution Five - 12 (Capital Gains On Depreciable Assets)

The only tax consequence would be a taxable capital gain of $4,500 [(1/2)($51,000 - $42,000)].

Exam Exercise Solution Five - 13 (Recapture)

The required information would be calculated as follows:

UCC Of The Class At The Beginning Of The Year	$7,423
Deduct: Dispositions During The Year - Lesser Of:	
• Capital Cost = $7,500	
• Proceeds Of Disposition = $7,950	(7,500)
Negative Ending Balance	($ 77)
Recapture Of CCA	77
January 1, 2017 UCC balance	Nil

The effect would be an addition to business income of $77 in recaptured CCA. While there would also be a taxable capital gain of $225 [(1/2)($7,950 - $7,500)], this would not be included in business income.

Exam Exercise Solution Five - 14 (Recapture)

The required information would be calculated as follows:

UCC Of The Class At The Beginning Of The Year	$32,400
Deduct: Dispositions During The Year - Lesser Of:	
• Capital Cost = $62,300	
• Proceeds Of Disposition = $41,800	(41,800)
Negative Ending Balance	($ 9,400)
Recapture Of CCA	9,400
January 1, 2017 UCC balance	Nil

The effect would be an addition to 2016 net business income of $9,400 in recaptured CCA.

Exam Exercise Solution Five - 15 (Terminal Loss)

The required information would be calculated as follows:

UCC Of The Class At The Beginning Of The Year	$56,472
Deduct: Dispositions During The Year - Lesser Of:	
• Capital Cost = $144,000	
• Proceeds Of Disposition = $41,500	(41,500)
Ending Balance With No Remaining Assets	$14,972
Terminal Loss	(14,972)
January 1, 2017 UCC balance	Nil

As there is a positive balance in the class at the end of the year, but no remaining assets, there would be a terminal loss of $14,972. This loss is deducted in the calculation of net business income. As there is no balance in Class 29 on December 31, 2016, no CCA could be taken.

Exam Exercise Solution Five - 16 (Terminal Loss)

The required information would be calculated as follows:

UCC Of The Class At The Beginning Of The Year	$ 83,400
Deduct: May 1 Disposition - Lesser Of:	
• Capital Cost = $110,000	
• Proceeds Of Disposition = $92,400	(92,400)
June 1 Acquisitions	105,000
Deduct: December 1 Disposition - Lesser Of:	
• Capital Cost = $105,000	
• Proceeds Of Disposition = $65,000	(65,000)
Ending Balance With No Remaining Assets	$31,000
Terminal Loss	(31,000)
January 1, 2017 UCC balance	Nil

As there is a positive balance in the class at the end of the year, but no remaining assets, there would be a terminal loss of $31,000. This loss is deducted in the calculation of net business income. As there is no balance in Class 10 on December 31, 2016, no CCA could be taken.

Exam Exercise Solution Five - 17 (Separate Class Election)

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

	No Election 5 Copiers	With Election 2 Copiers	With Election 3 Copiers
January Acquisitions At $5,500	$27,500	$11,000	$16,500
Dispositions At $2,000	(4,000)	(4,000)	N/A
Terminal Loss		$ 7,000	
December Acquisitions At $6,000	12,000	$12,000	
One-Half Net Additions	(17,750)	(6,000)	(8,250)
Base Amount For CCA Claim	$17,750	$ 6,000	$ 8,250
Class 8 CCA Rate	20%	20%	20%
CCA For 2016	$ 3,550	$ 1,200	$ 1,650

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

Exam Exercise Solution Five - 18 (Separate Class Election)

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

	No Election	With Election
First Purchase [(3)($23,000)]	$69,000	$69,000
Dispositions [(3)($2,500)]	(7,500)	(7,500)
Terminal Loss		$61,500
November Purchase [(3)($21,500)]	64,500	$64,500
One-Half Net Additions	(63,000)	(32,250)
Base Amount For CCA Claim	$63,000	$32,250
Class 8 CCA Rate	20%	20%
CCA For 2016	$12,600	$ 6,450

If no election is made, there will be a deduction for CCA of $12,600. Alternatively, if each machine is allocated to a separate class, there will be a deduction for CCA of $6,450. In addition, there will be a terminal loss of $61,500. The use of the election increases the total deductible amount by $55,350 ($6,450 + $61,500 - $12,600).

Exam Exercise Solution Five - 19 (CEC With Disposition)

The income inclusion can be calculated as follows:

	CEC Balance	CEC Deductions
2014 CEC Addition [(3/4)($123,000)]	$92,250	
CEC Amount At 7 Percent	(6,458)	$ 6,458
Balance January 1, 2015	$85,792	
CEC Amount At 7 Percent	(6,005)	6,005
Balance January 1, 2016	$79,787	
Proceeds From Sale [(3/4)($118,200)]	(88,650)	
Balance After Sale	($ 8,863)	$12,463

The negative balance in the CEC account after the sale is less than the total of the CEC deductions in the past two years ($12,463). As a result, the entire $8,863 will be included in income in 2016 without adjustment.

Exam Exercise Solution Five - 20 (CEC With Disposition)

The income inclusion can be calculated as follows:

	CEC Balance	CEC Deductions
2014 CEC Addition [(3/4)($48,000)]	$36,000	
CEC Amount At 7 Percent	(2,520)	$ 2,520
Balance January 1, 2015	$33,480	
CEC Amount At 7 Percent	(2,344)	2,344
Balance January 1, 2016	$31,136	
Proceeds From Sale [(3/4)($84,000)]	(63,000)	
Balance After Sale	($31,864)	$4,864

To the extent of the $4,864 in CEC deductions prior to the disposition, this amount will be included in income in full. The additional negative balance of $27,000 will be converted from a 3/4 amount to a 1/2 amount, resulting in a further income inclusion of $18,000 [($27,000)(2/3)]. The total income inclusion will be $22,864 ($4,864 + $18,000).

Exam Exercise Solution Five - 21 (CEC Election)

The following table compares the balance in the CEC account assuming the election is not made with the balance assuming the election is made:

	No Election	With Election
2015 Addition [(3/4)($529,000)]	$396,750	$396,750
CEC Amount [($396,750)(7%)]	(27,773)	(27,773)
January 1, 2016 CEC Balance	$368,977	$368,977
Proceeds Of Sale [(3/4)($124,000)]	(93,000)	Nil
Deemed Proceeds Of Sale [(3/4)($86,000)]	Nil	(64,500)
Balance After Sale	$275,977	$304,477
Taxable Capital Gain	N/A	$ 19,000

If no election is made, there will be no income inclusion and the only tax consequence of the disposition is a reduction in the current and future CEC amounts.

If an election is made, there would be a capital gain of $38,000 ($124,000 - $86,000), resulting in an income inclusion of $19,000 [(1/2)($38,000)] and a balance in the CEC account that is $28,500 ($304,477 - $275,977) higher. Note that this $28,500 equals three-quarters of the $38,000 capital gain that was recognized using the election.

TIF Solution Five - 5A

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

A. 3

B. 4

C. 9

D. 5

E. 7

F. 1

G. 2

H. 8

The two unused definitions are as follows:

Eligible Capital Expenditure = 6

CCA = 10

TIF Solution Five - 5B

For some terms there is both a 100 percent correct answer and an answer that is close. We have indicated the “close answer” in brackets.

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

A. 4 (not 9)

B. 6 (not 2)

C. 12

D. 7

E. 10

F. 1 (not 13)

G. 3

H. 11 (not 5)

The two unused definitions are as follows:

Eligible Capital Expenditure = 8

CCA = 14

TIF Solution Five - 6

2013 Solution

The required calculations are as follows:

Opening Balance	Nil
Additions To Class 10 [(20 Cars)($21,500)]	$430,000
One-Half Net Additions [(1/2)($430,000)]	(215,000)
CCA Base	$215,000
CCA [(30%)($215,000)(122/365)]	(21,559)
One-Half Net Additions	215,000
Class 10 UCC For January 1, 2014	$408,441

As the business was established on September 1, 2013, its operations were carried out for 122 days in 2013, and only a proportionate share of the annual CCA charge may be taken. We would call your attention to the fact that it is the length of the taxation year, not the period of ownership of the assets, that establishes the fraction of the year for which CCA is to be recorded.

2014 Solution

The required calculations are as follows:

Opening Balance For Class 10	$408,441
Additions [(6 Cars)($22,800)]	136,800
Dispositions - Lesser Of:	
• Capital Cost = 6 @ $21,500 = $129,000	
• Proceeds Of Disposition = 6 @ $11,400 = $68,400	(68,400)
One-Half Net Additions [(1/2)($136,800 - $68,400)]	(34,200)
CCA Base	$442,641
CCA [(30%)($442,641)]	(132,792)
One-Half Net Additions	34,200
Class 10 UCC For January 1, 2015	$344,049

2015 Solution

With respect to Class 10 cars, the required calculations are as follows:

Opening Balance For Class 10	$344,049
Additions [(18 Cars)($24,300)]	437,400
Dispositions - Lesser Of:	
• Capital Cost = 14 @ $21,500 = $301,000	
• Proceeds Of Disposition = $137,200	(137,200)
One-Half Net Additions [(1/2)($437,400 - $137,200)]	(150,100)
CCA Base	$494,149
CCA [(30%)($494,149)]	(148,245)
One-Half Net Additions	150,100
Class 10 UCC For January 1, 2016	$496,004

With respect to the BMW convertibles, each would have to be allocated to a separate Class 10.1. Further, the addition to each Class 10.1 would be limited to $30,000. The required calculations would be as follows:

	BMW 1 Class 10.1	BMW 2 Class 10.1
Acquisitions	$30,000	$30,000
One-Half Net Additions	(15,000)	(15,000)
CCA Base	$15,000	$15,000
CCA [(30%)($15,000)]	(4,500)	(4,500)
One-Half Net Additions	15,000	15,000
UCC For January 1, 2016	$25,500	$25,500

2016 Solution

The required calculations for the Class 10 vehicles are as follows:

Opening Balance For Class 10	$496,004
Dispositions - Lesser Of:	
• Capital Cost = 24 @ $24,300 = $583,200	
• Proceeds Of Disposition = 24 @ $8,300 = $199,200	(199,200)
Balance Before Terminal Loss	$296,804
Terminal Loss	(296,804)
UCC For January 1, 2017	Nil

After all of the assets in Class 10 have been retired there is still a $296,804 balance in the UCC. This results in a terminal loss that will be deducted in full from the Haddad brothers' other income. How this deduction will be shared by the two brothers will depend on the terms of their partnership agreement for the delivery business. The terminal loss will also be deducted from the UCC balance.

With respect to the two Class 10.1 assets, no recapture or terminal losses can be recorded on these assets. However, in the year of disposal, taxpayers are allowed to deduct one-half year of CCA. Given the short fiscal final year, this means that on each of the Class 10.1 vehicles there would be a CCA deduction of $2,869 [(1/2)(30%)($25,500)(9/12)] for a total of $5,738.

TIF Solution Five - 7

Part A

The maximum CCA for the 3 years would be calculated as follows:

2014	**Class 1**	**Class 10**	**Class 8**
Opening Balance	Nil	Nil	Nil
Additions	$180,000	$150,000	$48,000
One-Half Net Additions	(90,000)	(75,000)	(24,000)
CCA Base	$ 90,000	$ 75,000	$24,000
Maximum CCA			
Class 1 [(6%)($90,000)(275 ÷ 365)]*	(4,068)		
Class 10 [(30%)($75,000)(275 ÷ 365)]		(16,952)	
Class 8 [(20%)($24,000)((275 ÷ 365)]			(3,616)
One-Half Net Additions	90,000	75,000	24,000
January 1, 2015 UCC	$175,932	$133,048	$44,384

*As the Class 1 building is being used 100 percent for non-residential purposes, it would qualify for the 6 percent CCA rate.

The total maximum CCA for 2014 would be $24,636 ($4,068 + $16,952 + $3,616).

2015	**Class 1**	**Class 10**	**Class 8**
Beginning UCC	$175,932	$133,048	$44,384
Additions	Nil	72,000	Nil
Disposition - Lesser Of:			
Capital Cost = $75,000			
Proceeds = [(3)($14,000)] = $42,000	Nil	(42,000)	Nil
One-Half Net Additions			
[(1/2)($72,000 - $42,000)]	Nil	(15,000)	Nil
CCA Base	$175,932	$148,048	$44,384
Maximum CCA			
Class 1 [(6%)($175,932)	(10,556)		
Class 10 [(30%)($148,048)]		(44,414)	
Class 8 [(20%)($44,384)]			(8,877)
One-Half Net Additions	Nil	15,000	Nil
January 1, 2016 UCC	$165,376	$118,634	$35,507

The total maximum CCA for 2015 would be $63,847 ($10,556 + $44,414 + $8,877).

2016	Class 1	Class 10	Class 10.1	Class 8
Beginning UCC	$165,376	$118,634	Nil	$35,507
Additions (Class Maximum)*	Nil	Nil	$30,000	Nil
Class 10 Disposition - Lesser Of:				
Capital Cost = $25,000				
Proceeds = $27,000	N/A	(25,000)	N/A	N/A
Class 8 Dispositions - Lesser Of:				
Capital Cost = $12,000				
Proceeds = Nil	N/A	N/A	N/A	Nil
One-Half Net Additions				
[(1/2)($30,000)]	N/A	N/A	(15,000)	N/A
Balance	$165,376	$ 93,634	$15,000	$35,507
Maximum CCA				
Class 1 [(6%)($165,376)]	(9,923)			
Class 10 [(30%)($93,634)]		(28,090)		
Class 10.1 [(30%)($15,000)]			(4,500)	
Class 8 [(20%)($35,507)]				(7,101)
One-Half Net Additions	N/A	N/A	15,000	N/A
January 1, 2017 UCC	$155,453	$ 65,544	$25,500	$28,406

*Additions to Class 10.1 limited to $30,000.

The total maximum CCA for 2016 would be $49,614 ($9,923 + $28,090 + $4,500 + $7,101).

Part B

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

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

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

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

TIF Solution Five - 8

The maximum CCA for the 3 years would be calculated as in the following schedules:

2014	Class 1	Class 10	Class 8
Opening Balance	Nil	Nil	Nil
Additions			
Class 1 ($326,000 - $53,000)	$273,000		
Class 10 [(12)($23,000)]		$276,000	
Class 8			$85,000
One-Half Net Additions	(136,500)	(138,000)	(42,500)
CCA Base	$136,500	$138,000	$42,500
Maximum CCA			
Class 1 [(6%)($136,500)(245 ÷ 365)]*	(5,497)		
Class 10 [(30%)($138,000)(245 ÷ 365)]		(27,789)	
Class 8 [(20%)($42,500)(245 ÷ 365)]			(5,705)
One-Half Net Additions	136,500	138,000	42,500
January 1, 2015 UCC	$267,503	$248,211	$79,295

*As the Class 1 building is being used 100 percent for non-residential purposes and is allocated to a separate Class 1, it would qualify for the 6 percent CCA rate.

The total maximum CCA for 2014 would be $38,991 ($5,497 + $27,789 + $5,705).

2015	Class 1	Class 10	Class 8	Class 10.1
Beginning UCC	$267,503	$248,211	$79,295	Nil
Additions				
Class 1	Nil			
Class 10 [(5)($27,000)]		135,000		
Class 8			Nil	
Class 10.1*				$30,000
Class 10 Disposition - Lesser Of:				
Capital Cost = $115,000				
Proceeds = $80,000	Nil	(80,000)	Nil	
One-Half Net Additions	Nil	(27,500)	Nil	(15,000)
CCA Base	$267,503	$275,711	$79,295	$15,000
Maximum CCA				
Class 1 [(6%)($267,503)]	(16,050)			
Class 10 [(30%)($275,711)]		(82,713)		
Class 8 [(20%)($79,295)]			(15,859)	
Class 10.1 [(30%)($15,000)]				(4,500)
One-Half Net Additions		27,500	Nil	15,000
January 1, 2016 UCC	$251,453	$220,498	$63,436	$25,500

*The CCA base for the luxury car is limited to $30,000.

The total maximum CCA for 2015 would be $119,122 ($16,050 + $82,713 + $15,859 + $4,500).

2016	Class 1	Class 10	Class 8
Beginning UCC	$251,453	$220,498	$63,436
Additions	Nil	Nil	Nil
Proceeds Of Disposition - Lesser Of:			
$289,000 Vs. $273,000	(273,000)		
$296,000 Vs. $135,500		(135,500)	
$85,000 Vs. $12,300			(12,300)
Balance With No Remaining Assets	($21,547)	$ 84,998	$51,136
Class 1 Recapture	21,547		
Terminal Losses		(84,998)	(51,136)
January 1, 2017 UCC	Nil	Nil	Nil

With respect to the Class 10.1 vehicle, the *Income Tax Regulations* permit taking one-half of the regular CCA in the year of disposition. Since the final year is not a short fiscal period, this amount would be $3,825 [(1/2)(30%)($25,500)].

No recapture or terminal loss can be recognized with respect to Class 10.1. However, the balance would be eliminated, leaving a January 1, 2017 UCC of nil.

The only CCA for 2016 would be the Class 10.1 CCA of $3,825 as Classes 1, 8 and 10 had no CCA for the year. There would be recapture of $21,547 for Class 1, a terminal loss of $84,998 for Class 10 and a $51,136 terminal loss for Class 8.

There would also be a taxable capital on the building of $8,000 [(1/2)($289,000 - $273,000)].

TIF Solution Five - 9

Note To Instructor Although the replacement property rules (covered in Chapter 8) might be considered relevant as a building was burned down and a new building was purchased, we have specified that a warehouse was disposed of, and an office building was purchased, to avoid that complication in this problem.

Class 1

As it is a new building, is going to be used 100 percent for non-residential purposes, and it has been put in a separate Class, it is eligible for the enhanced CCA rate of 6 percent. Given this, the required information for this Class is as follows:

January 1, 2016 UCC	Nil
Additions ($623,000 - $145,000)	$478,000
One-Half Net Additions	(239,000)
Balance Subject To CCA	$239,000
CCA [(6%)($239,000)]	(14,340)
One-Half Net Additions	239,000
January 1, 2017 UCC	$463,660

Class 3

The required information for this Class is as follows:

January 1, 2016 UCC	$798,000
Dispositions - Lesser Of:	
Capital Cost = $150,000	
Proceeds Of Disposition = $185,000	(150,000)
Balance Subject To CCA	$648,000
CCA [(5%)($648,000)]	(32,400)
January 1, 2017 UCC	$615,600

There would also be a taxable capital gain from the disposition of $17,500 [(1/2)($185,000 - $150,000)].

Class 8

The required calculations for this class would be as follows:

January 1, 2016 UCC		$346,000
Additions	$105,000	
Dispositions - Lesser Of:		
• Capital Cost = $83,000		
• Proceeds Of Disposition = $75,000	(75,000)	30,000
One-Half Net Additions [(1/2)($30,000)]		(15,000)
Balance Subject To CCA		$361,000
CCA [(20%)($361,000)]		(72,200)
One-Half Net Additions		15,000
January 1, 2017 UCC Balance		$303,800

Class 10 - Vehicles

The required information for this Class would be calculated as follows:

January 1, 2016 UCC		$150,000
Additions [(3)($25,000)]	$75,000	
Disposition of Truck - Lesser Of:		
• Capital Cost = $42,000		
• Proceeds Of Disposition = $18,000	(18,000)	57,000
One-Half Net Additions [(1/2)($57,000)]		(28,500)
Balance Subject To CCA		$178,500
CCA [(30%)($178,500)]		(53,550)
One-Half Net Additions		28,500
January 1, 2017 UCC Balance		$153,450

Class 10.1

In the case of Class 10.1, recapture is not included in income and terminal losses cannot be deducted. However, in the year of disposition, one-half of the usual CCA can be deducted. This would be $2,678 [(1/2)(30%)($17,850)]. The January 1, 2017 UCC balance would be nil.

Class 13

The 2014 improvements are being written off over 10 years, the original term of the lease (8 years), plus the first renewal of two years. As the Company takes maximum CCA each year, the CCA taken in 2014 and 2015 must equal 15 percent [(10%)(1/2) + 10%] of the cost of the improvements. Given this, the January 1, 2016 UCC must equal 85 percent of the cost of the improvements. This indicates that the cost must have been $50,000 ($42,500 ÷ 85%).

Given this, the required information for this Class would be as follows:

January 1, 2016 Balance		$42,500
Additions		40,000
Balance Subject To CCA		$82,500
CCA:		
• First Improvements ($50,000 ÷ 10)	($5,000)	
• Current Improvements [($40,000 ÷ 8)(1/2)]	(2,500)	(7,500)
January 1, 2017 UCC Balance		$75,000

Class 29

The required information for this Class would be calculated as follows:

January 1, 2016 Balance	$63,000
Disposition - Lesser Of:	
• Capital Cost = $252,000	
• Proceeds Of Disposition = $51,000	(51,000)
Balance Before Terminal Loss	$12,000
Terminal Loss	(12,000)
January 1, 2017 UCC Balance	Nil

After all of the assets in Class 29 have been retired there is still a $12,000 UCC balance. This results in a terminal loss that will be deducted in full from the Net Income of Fortin Aluminum. The terminal loss will also be deducted from the UCC balance.

Class 50

The required information for this Class can be calculated as follows:

January 1, 2016 Balance	$23,000
Additions	18,000
One-Half Net Additions [(1/2)($18,000)]	(9,000)
CCA Base	$32,000
CCA [(55%)($32,000)]	(17,600)
One-Half Net Additions	9,000
January 1, 2017 UCC	$23,400

Summary Of The Results (Not Required)

The maximum CCA for the year ending December 31, 2016 and the January 1, 2017 UCC balances can be summarized as follows:

	Maximum CCA	UCC
Class 1	$14,340	$463,660
Class 3	32,400	615,600
Class 8	72,200	303,800
Class 10	53,550	153,450
Class 10.1	2,678	Nil
Class 13	7,500	75,000
Class 29	Nil	Nil
Class 50	17,600	23,400

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

Taxable Capital Gain On Class 3 Building	$17,500
Terminal Loss On Class 29 Assets	(12,000)
Total Addition	$ 5,500

TIF Solution Five - 10

Part A

The required calculation of the maximum CCA and CEC for 2016 is as follows:

Class 8 (Note 1)	$ 46,600
Class 10 [(30%)($152,000)]	45,600
Class 12 (Note 2)	56,000
Class 13 (Note 3)	32,000
CEC [(7%)($210,000)]	14,700
Maximum Total	$194,900

Note 1 The Class 8 CCA would be calculated as follows:

Opening Balance	$220,000
Additions	42,000
Proceeds Of Disposition (Less Than Cost)	(16,000)
One-Half Net Additions [(1/2)($42,000 - $16,000)]	(13,000)
CCA Base	$233,000
CCA Rate	20%
Maximum CCA	$ 46,600

Note 2 The rate for Class 12 is 100 percent. However, some additions to this Class are subject to the half-year rules. The presence of an opening balance of $56,000 indicates that there must have been $112,000 of costs in 2015 that were subject to this rule. Given this, the entire balance could be deducted in 2016.

Note 3 The $272,000 balance in Class 13 is equal to 85 percent of $320,000. This means that during the two years 2014 and 2015, 15 percent of their cost was deducted as CCA. As the half-year rules are applicable to this Class, this represents a half year for 2014 and a full year for 2015. Since Class 13 is a straight-line Class, this indicates that the CCA rate is 10 percent (15% ÷ 1.5). Based on this analysis, maximum CCA for 2016 would be $32,000 [(10%)($320,000)].

Part B

Since the Company only has Net and Taxable Income before CCA and CEC of $51,000 and the problem states that loss carry overs should not be considered, maximum CCA and CEC would not be deducted. Only $51,000 in CCA and CEC should be taken in order to reduce the Taxable Income to nil.

As to which balances of CCA or CEC should be reduced, the usual procedure is to deduct the required amount from the balances with the lowest rates. By leaving the balances with higher rates untouched, larger amounts of CCA and CEC can be deducted in later periods as required.

Taking this approach, the recommended CCA and CEC deductions would be as follows:

CEC (Maximum Available)	$14,700
Class 13 (Maximum Available)	32,000
Class 8 ($51,000 - $14,700 - $32,000)	4,300
Total CCA	$51,000

The deduction of this amount of CCA and CEC would serve to reduce Taxable Income to nil.

TIF Solution Five - 11

Sale Of Equipment

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

Opening UCC Balance	$ 2,100
Dispositions - Lesser Of:	
• Capital Cost = $26,000	
• Proceeds Of Disposition = $21,000	(21,000)
Negative Ending Balance	($18,900)
Recaptured CCA	18,900
January 1, 2017 UCC Balance	Nil

There would be no Class 8 CCA for this year. The sale of the equipment would increase Net Income For Tax Purposes of Vance Enterprises by $18,900.

Sale Of Buildings

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

Opening UCC Balance	$205,000
Dispositions - Lesser Of:	
• Capital Cost = $250,000	
• Proceeds Of Disposition = $262,000 ($342,000 - $80,000)	(250,000)
Negative Ending Balance	($ 45,000)
Recaptured CCA	45,000
January 1, 2017 UCC Balance	Nil

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

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

There would be no Class 1 CCA for this year. The sale of the buildings would increase Net Income For Tax Purposes of Vance Enterprises by $51,000 ($45,000 + $6,000). As the adjusted cost base of the land is equal to the proceeds of disposition, there is no gain on the disposition of the land.

Leasehold Improvements

The leasehold improvements must be included in Class 13 and are subject to straight line write-off over the life of the lease. However, the minimum life that may be used is five years, resulting in a 2016 CCA deduction of $3,900 [(1/2)($39,000 ÷ 5)] and a January 1, 2017 Class 13 UCC of $35,100.

Sale Of Automobile

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

Opening UCC Balance	$10,200
Dispositions - Lesser Of:	
• Capital Cost = $20,500	
• Proceeds Of Disposition = $8,900	(8,900)
Balance Before Terminal Loss	$ 1,300
Terminal Loss	(1,300)
January 1, 2017 UCC Balance	Nil

Since the capital cost of the automobile is less than the prescribed limit, the automobile is not a Class 10.1 asset. This terminal loss must be deducted in the year ending December 31, 2016. As a consequence, there will be no Class 10 CCA for the year.

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

Sale Of Goodwill

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

Opening CEC Balance	Nil
Proceeds [(3/4)($110,000)]	($82,500)
Balance	($82,500)

To the extent that Ms. Vance has deducted amounts under ITA 20(1)(b), this negative balance must be included in income in full. However, it does not appear that Vance Enterprises has made any such deductions. As a consequence, the full amount will be adjusted to the current capital gains inclusion rate of one-half. This is done by multiplying the $82,500 by two-thirds, resulting in an income inclusion of $55,000.

Summary Of CCA And UCC Results (Not Required)

The maximum CCA for the year ending December 31, 2016 and the January 1, 2017 UCC balances can be summarized as follows:

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

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

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

TIF Solution Five - 12

The tax consequences for the three years 2014 through 2016 are calculated as follows:

	CEC Balance	CEC Deductions
2014 Additions To CEC [(3/4)($150,000 + $225,000 + $180,000)]	$416,250	
2014 CEC Amount [($416,250)(7%)]	(29,138)	$29,138
CEC Balance - January 1, 2015	$387,112	
Disposition [(3/4)($82,000)]	(61,500)	
Subtotal	$325,612	
2015 CEC Amount [($325,612)(7%)]	(22,793)	22,793
CEC Balance - January 1, 2016	$302,819	
Dispositions [(3/4)($210,000 + $283,000)]	(369,750)	
Balance After Sale	($ 66,931)	$51,931

As can be seen in the preceding table, $51,931 of the negative balance reflects CEC deductions that have been made in previous years. This full amount will have to be included in 2016 income.

The total gain on the 3 acquisitions and disposals can be calculated as follows:

Proceeds Of Disposition ($82,000 + $210,000 + $283,000)	$575,000
Cost ($150,000 + $225,000 + $180,000)	(555,000)
Total Gains	$ 20,000

The remaining $15,000 ($66,931 - $51,931) of the negative CEC balance reflects three-quarters of this $20,000 gain. This will have to be converted to the one-half capital gains inclusion rate by multiplying by two-thirds.

The result is $10,000 [(2/3)($15,000)], or one-half of the total gain on the disposal.

This gives a total 2016 income inclusion of $61,931 ($51,931 + $10,000).

TIF Solution Five - 13

Part A

The maximum CEC deductions for the 3 years would be calculated as follows:

No Election	CEC Balance	CEC Deductions
Balance January 1, 2014	$ Nil	
Acquisition [(3/4)($250,000 + $175,000)]	318,750	
Balance Before CEC Deduction	$318,750	
2014 CEC Amount [(7%)($318,750)]	(22,313)	$22,313
Balance January 1, 2015	$296,437	
Disposition [(3/4)($225,000)]	(168,750)	
Balance Before CEC	$127,687	
2015 CEC Amount [(7%)($127,687)]	(8,938)	8,938
Balance January 1, 2016	$118,749	
Disposition [(3/4)($350,000)]	(262,500)	
Balance After Sale	($143,751)	$31,251

As shown in the preceding schedule, the maximum CEC deductions are $22,313 in 2014, $8,938 in 2015, and nil in 2016.

Part B

For 2015, there is positive balance in the CEC after the disposition. This means that no amount will be included in income as a result of this disposition.

With respect to the 2016 disposition, there is a negative balance of $143,751. Of this total, $31,251 represents the CEC deductions from previous years. This amount will be included in 2016 income in full.

The remaining $112,500 ($143,751 - $31,251) represents three-quarters of $150,000. This $150,000 is the excess of the proceeds of the disposals over the cost of additions to the account ($225,000 + $350,000 - $250,000 - $175,000). The $112,500 will be multiplied by two-thirds to arrive at an income inclusion of $75,000.

The total income inclusion for 2016 will be $106,251 ($31,251 + $75,000).

Part C

The ITA 14(1.01) election cannot be used for dispositions of goodwill. However, because the disposition proceeds for the unlimited life franchise exceeded the cost, the election can be used for the 2015 disposition. Its use will result in the following income inclusion in that year:

Proceeds Of Disposition	$225,000
Cost Of Franchise	(175,000)
Capital Gain	$ 50,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 25,000

The use of the election would also alter the CEC schedule as follows:

With Election	CEC Balance	CEC Deductions
Balance January 1, 2014	$ Nil	
Acquisition [(3/4)($250,000 + $175,000)]	318,750	
Balance Before CEC Deduction	$318,750	
2014 CEC Amount [(7%)($318,750)]	(22,313)	$22,313
Balance January 1, 2015 **(No Change From Part A)**	**$296,437**	
Disposition [(3/4)($175,000)] (Election Used)	(131,250)	
Balance Before CEC Deduction	$165,187	
2015 CEC Amount [(7%)($165,187)]	(11,563)	11,563
Balance January 1, 2016	$153,624	
Disposition [(3/4)($350,000)] (Election Can't Be Used)	(262,500)	
Balance After Sale	($108,876)	$33,876

To the extent of the $33,876 CEC deducted, this full amount would be included in 2016 income. The balance of $75,000 ($108,876 - $33,876) would be multiplied by two-thirds, resulting in an additional income inclusion of $50,000. The total 2016 income inclusion would be $83,876 ($33,876 + $50,000).

Part D

The required comparison would be as follows:

Results Without Election	
2016 Income Inclusion	$106,251
2014 And 2015 CEC Amounts Deducted	(31,251)
Net Income Inclusion	$ 75,000

Results With Election	
2015 Taxable Capital Gain	$25,000
2016 Income Inclusion	83,876
2014 And 2015 CEC Amounts Deducted	(33,876)
Net Income Inclusion	$75,000

The total of the CEC deductions and income inclusions is equal to $75,000 whether or not the election is used. However, when the election is used, $25,000 of this total is recorded as a capital gain, rather than as business income.

The probable reason for making this election would be that Altec has unused allowable capital losses from the current or previous years. By making this election the Company has created a taxable capital gain which will allow for the use of up to $25,000 in allowable capital losses. If this is not the case, using the election has added $25,000 to income a year earlier than otherwise.

TIF Solution Five - 14

Note To Instructor: The replacement property rules are covered in Chapter 8 and are not taken into consideration in this problem for the building.

Class 1

The calculations related to the building that was replaced are as follows:

Opening UCC Balance	$478,695
Disposition - Lesser Of:	
Proceeds = $525,000 ($650,000 - $125,000)	
Capital Cost = $545,000 ($625,000 - $80,000)	(525,000)
Negative Ending Balance = Recapture Of CCA	($ 46,305)

There is also a capital gain resulting from the sale of the land. However, the requirements of the problem are limited to CCA, recapture, and terminal losses.

Since the replacement building is new, used 100 percent for non-residential purposes and allocated to a separate Class 1, it qualifies for an enhanced CCA rate. As it is not used for manufacturing and processing, the enhanced rate is 6 percent. Using this rate, the CCA on the new building would be as follows:

Opening UCC Balance	Nil
Additions ($745,000 - $125,000)	$620,000
One-Half Net Additions [(1/2)($620,000)]	(310,000)
CCA Base	$310,000
Rate	6%
Maximum CCA	$ 18,600

Class 8

The required calculation here would be as follows:

Opening Class 8 Balance	$243,000
Additions	74,000
Disposals: Lesser Of:	
Capital Cost = $56,000	
Proceeds = $17,000	(17,000)
One-Half Net Additions [(1/2)($74,000 - $17,000)]	(28,500)
CCA Base	$271,500
Rate	20%
Maximum CCA	$ 54,300

Class 10

The required calculations here would be as follows:

Opening UCC Balance And CCA Base	$126,000
Rate	30%
Maximum CCA	$ 37,800

Class 10.1

The Lexus would be allocated to a separate Class 10.1. The amount would be limited to $30,000, resulting in maximum CCA of $4,500 [(1/2)(30%)($30,000)]. The kilometers driven for personal purposes would affect the taxable benefit, but does not affect the CCA.

Class 13

Class 13 is a straight-line class. In this case, the term of the lease and one renewal totals ten years, resulting in a 10 year write off. The maximum CCA would be $15,000 ($150,000 ÷ 10).

Class 14

The limited life franchise would be allocated to Class 14 and amortized on a straight line basis over its legal life. Although this franchise was purchased on August 1, this would only affect the year of acquisition and the last year of its life. The maximum CCA would be for a complete year and would equal $7,750 ($62,000 ÷ 8).

CEC

The maximum deduction from the cumulative eligible capital account is calculated as follows:

2014 Addition [(3/4)($84,000)]	$63,000
CEC Amount At 7 Percent	(4,410)
January 1, 2015 Balance	$58,590
CEC Amount At 7 Percent	(4,101)
January 1, 2016 Balance	$54,489
Disposal [(3/4)($65,000)]	(48,750)
Balance After Disposal	$ 5,739
CEC Amount At 7 Percent	(402)
January 1, 2017 Balance (Not Required)	$ 5,337

Summary (Required)

The total maximum CCA and CEC write-off is calculated as follows:

Class 1	$ 18,600
Class 8	54,300
Class 10	37,800
Class 10.1	4,500
Class 13	15,000
Class 14	7,750
CEC Amount	402
Total CCA and CEC	$138,352

In addition, there is Class 1 recapture of $46,305.

Chapter Six Test Item File Solutions

TIF Solution Six - 1

1. The major types of income that make up Net Income For Tax Purposes are:

   - Employment Income
   - Business Income
   - Property Income
   - Capital Gains.

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

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

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

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

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

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

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

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

   - **CCA Calculations** When property income is being earned, the deduction of capital cost allowance (CCA) cannot be used to create or increase a net loss for the period. In addition, when property income is being earned by individuals, there is no requirement for a pro rata CCA reduction to reflect a short fiscal period. If business income is being earned, CCA can be used to create a loss. However, CCA deductions must be prorated for short fiscal periods.

   - **Attribution Rules** When property income is being earned, the income attribution rules (see Chapter 9) are applicable. This is not the case when business income is being earned.

- **Earned Income Calculations** Property income is not included in the determination of earned income, either with respect to RRSP contributions or the limit on child care cost deductions. Business income is included in these figures.
- **Expense Deductions** Certain expenses can be deducted against business income, but not property income. These include write-offs of cumulative eligible capital and travel expenses. In contrast, for individuals, there is a deduction for foreign taxes on property income in excess of 15 percent that is not available against foreign business income.

6. It is important because only one-half of capital gains is included income and only one-half of capital losses is deductible from income. For business income or loss, 100 percent is included or deducted. Also important is the fact that capital losses can only be deducted against capital gains. In contrast, business losses can be used to reduce other sources of income.

7. The required four items could be selected from the following criteria that are listed in the text:
   - Intent to sell or hold to produce income.
   - Length of ownership.
   - Number and frequency of transactions.
   - Relationship to the taxpayer's business.
   - Supplemental work on the property.
   - Nature of the assets.
   - Objectives declared in articles of incorporation.

8. For income tax purposes, assets are allocated to classes where specified rates are applied, using either declining balance or straight-line procedures. This procedure establish the maximum deduction. However, the taxpayer can deduct any amount from nil to this maximum amount. Further, there is no requirement that the portion to be deducted be established in a consistent manner from year-to-year.

   For accounting purposes, each individual asset is generally accounted for. While the accountant can choose from a variety of methods for calculating the amount of amortization, once a method is selected, it must be followed consistently from year-to-year. In addition, the full amount that results from the application of the selected method must be deducted. Deducting a lesser amount would not be acceptable under GAAP.

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

10. Although there are other reserves in the *Income Tax Act*, the three reserves that are given attention in the text are:
    - reserve for doubtful debts;
    - reserve for undelivered goods and services; and
    - reserve for unpaid amounts.

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

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

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

12. As described in the text, the constraints are as follows:

    - **ITA 20(1)(n)** indicates that no reserve can be deducted unless at least some part of the proceeds will not be received until at least two years after the date the property is sold (this two year requirement does not apply to sales of real property inventory).

    - **ITA 20(8)** specifies that no reserve can be deducted in a year, for any type of property, if the sale took place more than 36 months before the end of that year. In addition, the reserve is not available if the purchaser is a corporation controlled by the seller, or a partnership in which the seller has a majority interest.

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

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

14. If the land is being used to produce income, interest costs and property taxes associated with its ownership are fully deductible. For example, the land on which a factory building is situated is clearly being used to produce income and, as a consequence, the related interest and property taxes would be fully deductible.

    If, however, the land is vacant, interest and property taxes can only be deducted to the extent that the land produces net revenues. For example, if the vacant land is only being used for a parking lot, the interest and property taxes could be deducted to the extent of the net revenues from the parking activity.

    To the extent that interest and property taxes cannot be deducted, they can be added to the adjusted cost base of the land.

    A special rule applies to real estate companies whose principal business is leasing, rental or sale, or the development of land. They are permitted to deduct a base level amount, defined as interest at the prescribed rate on a $1 million principal amount.

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

16. The general rule is that expenditures made in foreign print or foreign broadcast media where the advertising message is directed primarily at the Canadian market cannot be deducted. This restriction does not apply where such foreign media expenditures are focused on non-Canadian markets.

    There is an exception to this general rule for foreign periodicals only. Canadian businesses can deduct 100 percent of advertising costs in these publications, without regard to whether it is directed at the Canadian market, provided 80 percent or more of its non-advertising content is original editorial content. If the periodical cannot meet the 80 percent criteria, only 50 percent of such advertising costs will be deductible.

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

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

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

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

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

21. For accounting purposes, estimated warranty costs can be recognized as a liability, with the recorded amount being charged to expense. In general, for tax purposes, warranty costs must be recognized on a cash basis. Estimated amounts cannot be deducted for tax purposes.

22. For income tax purposes, discounts on issued debt obligations cannot be amortized during the period that the bonds are outstanding. This means that deductible interest is based only on cash amounts of interest paid. However, when the bonds mature, the full maturity amount, including 100 percent of the discount, must be paid, resulting in a loss equal to the amount paid at maturity, less the original issue proceeds. If the bonds are issued for not less than 97 percent of their maturity amount and, if the effective yield is not more than 4/3 of the coupon rate, the full amount of the loss can be deducted when the maturity amount is paid. If these conditions are not met, the loss at maturity is treated in the same manner as a capital loss, with only one-half of the payment being deductible.

23. The *Income Tax Act* identifies three categories of farmers. These categories and the required treatment of losses for farmers that fall into each category are as follows:

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

    Full Time Farmers These are individuals who farm on a full-time basis. The full amount of their losses can be deducted against any other source of income. This category does not preclude the taxpayer having one or more other sources of income, provided these sources are subordinate to farming.

    Part-Time Farmers As described in ITA 31, these are farmers whose chief source of income is neither farming nor a combination of farming and some other source of income that is a subordinate source of income. They would also have to have a reasonable expectation of profit from farming. For farmers falling into this category the amount of farm losses that can be deducted against other sources of income is limited to $2,500, plus one-half of the next $30,000. This means the maximum deduction, based on a loss of $32,500, is $17,500. Losses that cannot be deducted in the current year can be carried over to previous or subsequent years to the extent of farm income in those years.

24. When accrual accounting is applied to the income of a professional, all of that taxpayer's work must be included in income, without regard to whether or not it has been billed. In contrast, under the billed basis of determining income, work in process that has not been billed can be excluded from income.

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

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

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

TIF Solution Six - 2

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

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

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

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

5. True.

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

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

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

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

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

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

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

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

14. True.

TIF Solution Six - 3

New For 2016/2017

1. C. A capital gain of $3,000 and business income of $20,600.

2. D. As long as some part of the proceeds for goods sold is not collectible until future periods, a reserve for uncollected amounts can be deducted. This is not correct in that there are restrictions on when such reserves can be used.

3. B. $9,906 [(30%)($11,662) + $950 + $6,500][38,000 ÷ 42,000].

4. D. Parking fines incurred by delivery vehicles making deliveries in congested areas.

5. C. Cost of sales can be determined using inventory valuation based on either replacement cost or net realizable value.

6. B. $4,550 [$6,800 - (1/2)($123,000 - $118,500)]

Retained From Previous Editions

7. C. Profit from the sale of inventory items

8. D. A net Business Loss of $7,000 [($45,000 - ($2,000 + $50,000)] x 100% = $7,000

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

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

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

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

13. B. business income. The intent at the time of acquisition was to earn a profit on the subdivision and resale of the land.

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

15. B. $30,000 + 500 – 200 = $30,300

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

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

18. D. Both A and B.

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

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

21. A. Business deduction of $4,318 [($7,200 + 1,000 +1,300) x 10,000/22,000]; and a taxable benefit of $0 Note: D would be the correct answer if the business was incorporated and owned the car.

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

23. A. A speeding ticket received by a truck delivering goods for resale.

24. D $4,835

House insurance	$ 880
House utilities	2,600
House repairs and maintenance	3,000
Mortgage interest	5,700
Property tax	1,600
Total	$13,780
Percentage (800 ÷ 3,000)	26-2/3%
Deductible portion	$3,675
Business liability insurance	400
Office supplies	760
Total	$4,835

25. C. Kyle can deduct the $650 of property taxes paid and $850 of the interest paid. He can only deduct interest and property tax on the vacant land up to the $1,500 in rent received.

26. A. $40,000 – 33,000 +1,200 – 2,300 = $5,900 net income before home expenses (can't create a loss)

27. D. [($23,700 - $4,100) x 50%] + (4,100 x 100%) = $13,900

28. B. $9,733 + ($75 x 12) + $1600 + $420 = $12,653
Lease payments – least of:
a) Actual lease payments ($950 -75) x 12 = $10,500
b) Basic formula ($800 x 365/30) = $9,733
c) Anti Avoidance formula [$10,500 x $30,000/(.85 x 38,000)] = $9,752

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

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

31. C. $15 late payment interest charged by utility company

32. D. Reasonable salary paid to a relative

33. B. $24,000 - accounting gain (10,000–500) + taxable capital gain (2,000 x 50%) = $15,500

34. A. $12,200 + ($28,000 /10) – [($28,000 – 2,100)(15%)] = $11,115

35. C. ($500 + 750) – [(3 + 5) x ($50 x 50%) = $1,050 limit is 2 conventions, $50/day deemed meals x 50%

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

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

38. D. $100,000 + $7,000 + $6,000 - $10,000 = $103,000

39. C. Jon can choose any date for his year end. However, if Jon chooses a non-calendar year end he will have to adjust his income by an amount referred to as "additional business income".

40. C. $6,700 on the accrual basis or $6,000 on the billed basis of recognition
Accrual basis: ($3,500 + 3,200) = $6,700 Billed basis: ($2,500 + 3,500) = $6,000

41. B. $2,500 + [(1/2)($9,500 - $2,500)] = $6,000

TIF Solution Six - 4

Exam Exercise Solution Six - 1 (Business Vs. Property Income)

While only a single transaction is involved, this could be considered an adventure or concern in the nature of trade. However, Martin does not have any plans to acquire additional rights, nor does he appear to have any intention of selling the rights that he has purchased. This strongly suggests that this is not an adventure or concern in the nature of trade. This would lead to the conclusion that the royalties he receives should be treated as property income, rather than business income. This being the case, any gain or loss on the disposition of these rights would be treated as a capital gain or loss.

Exam Exercise Solution Six - 2 (Business Income Vs. Capital Gains)

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

Exam Exercise Solution Six - 3 (Business Income Vs. Capital Gains)

As holding the internet domain names does not produce any income, they cannot be classified as capital assets. This means that the gains resulting from their sale would have to be considered business income which would not be eligible for capital gains treatment.

Exam Exercise Solution Six - 4 (Bad Debts And Reserve For Doubtful Debts)

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

Add: 2015 Reserve For Tax Purposes		$3,400
Deduct:		
2016 Actual Write-Offs	($3,600)	
2016 Reserve For Tax Purposes	(4,100)	(7,700)
2016 Net Deduction For Tax Purposes		($4,300)

Exam Exercise Solution Six - 5 (Bad Debts And Reserve For Doubtful Debts)

The net decrease will be $10,956 calculated as follows:

Add: 2015 Reserve For Tax Purposes		$12,300
Deduct:		
2016 Actual Write-Offs	($13,000)	
2016 Reserve For Tax Purposes [(4%)($256,400)]	(10,256)	(23,256)
2016 Net Deduction For Tax Purposes		($10,956)

Exam Exercise Solution Six - 6 (Reserve For Doubtful Debts And Undelivered Services)

The amount to be included in net business income would be calculated as follows:

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

Exam Exercise Solution Six - 7
(Reserve For Doubtful Debts And Undelivered Services)

The amount to be included in net business income would be calculated as follows:

Cash Sales	$123,000
Sales On Account	46,000
Reserve For Undelivered Services	(9,500)
Reserve For Doubtful Accounts	(4,000)
Total Increase	$155,500

Exam Exercise Solution Six - 8 (Reserve For Unpaid Amounts)

As some of the proceeds are not receivable for more than 2 years, a reserve can be deducted under ITA 20(1)(n). The maximum reserve, based on the gross profit of $216,000, and the net business income, for each of the 5 years would be as follows:

	Income	Proceeds Rec'd
2016 Reserve = [(100%)($216,000)] = $216,000	Nil	Nil
2017 Reserve = [(75%)($216,000)] = $162,000	$ 54,000	$107,000
2018 Reserve = [(50%)($216,000)] = $108,000	54,000	107,000
2019 Reserve = Nil (>36 Months From Sale Date)	108,000	107,000
2020 Reserve = Nil (All Proceeds Received)	Nil	107,000
Totals	$216,000	$428,000

As December 31, 2019 is more than 36 months after the sale was made, no reserve can be deducted for 2019 or 2020. Note that the technically correct calculation of income involves adding back the previous year's reserve and deducting the new reserve. For example, the calculation for 2018 involves adding back the 2017 reserve of $162,000 and deducting the new reserve of $108,000.

Exam Exercise Solution Six - 9 (Reserve For Unpaid Amounts)

As some of the proceeds are not receivable for more than 2 years, a reserve can be deducted under ITA 20(1)(n). Based on the gross profit of $62,000 ($125,000 - $63,000), the maximum reserve for each of the 4 years, as well as amounts to be included in income in each year, is as follows:

	Income	Proceeds Rec'd
2016 Reserve = [(60%)($62,000)] = $37,200	$24,800	$ 50,000
2017 Reserve = [(40%)($62,000)] = $24,800	12,400	25,000
2018 Reserve = [(20%)($62,000)] = $12,400	12,400	25,000
2019 Reserve = Nil (All Proceeds Received)	12,400	25,000
Totals	$62,000	$125,000

The 3 year time limit is not relevant as all of the proceeds are received within the fourth year. Note that the technically correct calculation of income involves adding back the previous year's reserve and deducting the new reserve. For example, the calculation for 2017 involves adding back the 2018 reserve of $24,800 and deducting the new reserve of $12,400.

Exam Exercise Solution Six - 10 (Interest In Thin Capitalizations)

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

Total Interest Paid To Mr. Roundtree [(7%)($5,250,000)]	$367,500
Maximum Deductible Interest [(7%)(1.5)($1,359,000)]	(142,695)
Disallowed Interest	$224,805

Exam Exercise Solution Six - 11 (Interest In Thin Capitalizations)

As Ms. Bergeron owns 40 percent of the common shares, she is clearly a specified shareholder under ITA 18(5). Her relevant equity balance would be $1,560,000 [$1,000,000 + (100%)($560,000)]. Given this, the disallowed interest would be calculated as follows:

Total Interest Paid To Ms. Bergeron [(9%)(1/2)($9,100,000)]	$409,500
Maximum Deductible Interest [(9%)(1.5)($1,560,000)]	(210,600)
Disallowed Interest	$198,900

Exam Exercise Solution Six - 12 (Work Space In The Home Costs)

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

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

Exam Exercise Solution Six - 13 (Work Space In The Home Costs)

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

	Part A	Part B	Part C
Utilities	$2,500	$ 2,500	$ 2,500
Maintenance And Repairs	3,100	3,100	3,100
Property Taxes	Nil	5,400	5,400
House Insurance	Nil	1,300	1,300
Interest On Mortgage	Nil	Nil	4,600
House CCA	Nil	Nil	12,000
Subtotal	$5,600	$12,300	$28,900
Percentage	18%	18%	18%
Subtotal	$1,008	$ 2,214	$5,202
Phone Line To Home Work Space	480	480	480
Employment/Business Related Long Distance Charges (100%)	560	560	560
Office Supplies	425	425	425
Maximum Deduction	$2,473	$ 3,679	$6,667

Exam Exercise Solution Six - 14 (Automobile Ownership Costs)

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

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

Exam Exercise Solution Six - 15 (Automobile Ownership Costs)

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

Capital Cost Allowance [(30%)(1/2)($30,000)]	$4,500
Interest Costs - Lesser Of:	
• Amount Paid = $2,000	
• [($10)(122 Days)] = $1,220	1,220
Total Deduction	$5,720

Exam Exercise Solution Six - 16 (Automobile Leasing Costs)

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

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

Exam Exercise Solution Six - 17 (Automobile Leasing Costs)

The amount he can deduct is limited to $2,306, the least of:

- $3,985 [($797)(5)];
- $4,080 [($800)(153/30)]; and
- $2,306 {[$3,985][$30,000 ÷ (85%)($61,000)]}

Exam Exercise Solution Six - 18 (Leases: Tax Vs. GAAP)

For tax purposes, the lease would be treated as an operating lease, with the deduction being based only on the lease payments. Under GAAP, the lease would have to be treated as a purchase and capitalized. This is because during the lease term the lease transfers "substantially all of the benefits and risks of ownership related to the leased property from the lessor to the lessee". This means that the accounting deductions would be for amortization on the capitalized asset and interest costs on the associated liability.

Exam Exercise Solution Six - 19 (Inventory Valuation)

The following calculations will be used in this solution.

Fair Market Value (Using Replacement Cost) [($24.00)(7,800)]	$187,200
Fair Market Value (Using Net Realizable Value) [(80%)($31.00)(7,800)]	$193,440
FIFO Cost [(5,300)($25.00) + (7,800 - 5,300)($21.00)]	$185,000
Average Cost [($23.89*)(7,800)]	$186,342

*Average per unit cost of $23.89 ($587,400 ÷ 24,600) calculated as follows:

Price	Units	Total
$23.00	7,500	$172,500
$28.00	5,000	140,000
$21.00	6,800	142,800
$25.00	5,300	132,500
Totals	24,600	$587,800

For tax purposes, the inventory value can be determined by any of the following methods.

- Fair Market Value (Using Replacement Cost)= $187,200
- Fair Market Value (Using Net Realizable Value) = $193,440
- Lower of $185,000 Cost (FIFO) or $187,200 Market (Replacement Cost) = $185,000
- Lower of $185,000 Cost (FIFO) or $193,440 Market (Net Realizable Value) = $185,000
- Lower of $186,342 Cost (Average Cost) or $187,200 Market (Replacement Cost) = $186,342
- Lower Of $186,342 Cost (Average Cost) or $193,440 Market (Net Realizable Value) = $186,342

Exam Exercise Solution Six - 20 (Additional Business Income)

Ms. Gabor's additional business income for 2016 will be $14,131 [($23,500)(92 Days ÷ 153 Days)]. The 92 days is for the period October 1 through December 31. The 153 days is for the period May 1 through September 30. The total business income that Ms. Gabor will have to report for 2016 is $37,631 ($23,500 + $14,131).

Exam Exercise Solution Six - 21
(Professional Income - Billed Basis Of Recognition)

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

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

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

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

Exam Exercise Solution Six - 22
(Professional Income - Billed Basis Of Recognition)

Mr. Volke's income for the current year under the three alternatives would be as follows:

Cash Basis The cash basis income would be $175,600 ($23,800 + $27,200 + $124,600).

Billed Basis The billed basis income would be $180,100 ($23,800 + $156,300).

Accrual Basis The accrual basis income would be $187,200.

Exam Exercise Solution Six - 23 (ITA 22 Election On Receivables)

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

Exam Exercise Solution Six - 24 (ITA 22 Election On Receivables)

If we assume that there is no election under ITA 22, Ms. Besson will have to include the $4,200 reserve in income. This will be partially offset by the deduction of an allowable capital loss of $1,600 [(1/2)($68,500 - $65,300)]. Assuming Ms. Besson has taxable capital gains against which the $1,600 loss can be deducted, the transaction will result in a net inclusion in income of $2,600 ($4,200 - $1,600).

Alternatively, if the ITA 22 election is jointly made, she will still have to include the $4,200 reserve in business income. However, in this case, the inclusion will be offset by a business income deduction of $3,200 ($68,500 - $65,300). In this case the net addition will be $1,000 ($4,200 - $3,200).

TIF Solution Six - 5A

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

A. 9

B. 8

C. 10

D. 1

E. 4

F. 11

G. 7

H. 3

The three unused definitions are as follows:

Cash Basis = 2

Taxation Year = 5

Business = 6

TIF Solution Six - 5B

For some terms there is both a 100 percent correct answer and an answer that is close. We have indicated the “close answer” in brackets.

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

A. 12

B. 11 (not 4)

C. 14 (not 13)

D. 1 (not 3)

E. 6 (not 10)

F. 15

G. 9

H. 5

The three unused definitions are as follows:

Cash Basis = 2

Taxation Year = 7

Business = 8

TIF Solution Six - 6

The results for the 2 years would be as follows:

	2016	2017
Cash Sales ($259,000 - $88,000)	$171,000	
Cash Sales ($360,000 - $72,000)		$288,000
Sales On Account	88,000	72,000
Reserve For Doubtful Debts:		
Add Prior Year Reserve	Nil	7,000
Deduct Current Year Reserve	(7,000)	(9,500)
Deduct Actual Write-Offs	Nil	(6,500)
Advances From Customers	27,000	21,000
Reserve For Undelivered Merchandise:		
Add Prior Year Reserve	Nil	27,000
Deduct Current Year Reserve	(27,000)	(21,000)
Gross Profit On Sale Of Unused Materials	15,000	Nil
Reserve For Unpaid Amounts:		
Add Prior Year Reserve		9,677
Deduct Current Year Reserve*		
{[$15,000][($62,000 - $22,000) ÷ $62,000]}	(9,677)	
{[$15,000][($62,000 - $42,000) ÷ $62,000]}		(4,839)
Net Effect	$257,323	$382,838

*As some of the proceeds on the sale of unused materials are not due until two years after the date of the sale, a reserve for unpaid amounts can be deducted. The three year time limit is not relevant as the full balance is paid off prior to the end of that period.

TIF Solution Six - 7

Part A

Under ITA 18(12), the following conditions must be satisfied in order for expenses related to work space in a self-contained domestic establishment to be deductible:

- the work space is either the individual's principal place of business; or
- the work space is used exclusively for the purpose of earning income from business and is used on a regular and continuous basis for meeting clients, customers, or patients of the individual in respect of the business.

With respect to Mr. Larson's mail order business, the allocated space in his home would appear to be his principal place of business. This means that he would be able to deduct work space in home costs in determining his net business income.

Part B

The calculation of the minimum net business income to be reported in Mr. Larson's personal tax return is as follows:

Revenues		$182,000
Expenses Other Than Home Work Space Costs:		
Cost Of Merchandise Sold	($98,000)	
Packaging Materials	(2,400)	
Shipping Costs	(4,600)	
Miscellaneous Office Supplies	(560)	
Telephone	(1,100)	
Printing Of Posters And Brochures	(420)	
CCA (Note 1)	(2,321)	(109,401)
Income Before Home Work Space Costs		$ 72,599
Less: Home Work Space Costs (Note 2)		(4,332)
Net Business Income		$ 68,267

Note 1 Maximum CCA amounts on the assets of the business (not including CCA on the house) for the short fiscal year would be calculated as follows (alternative calculations shown in the two columns):

	100%	Short Fiscal Year (335/365)
Class 8 [($18,500)(1/2)(20%)]	$1,850	$1,698
Class 50 [($1,430)(1/2)(55%)]	393	361
Class 12 [($570)(1/2)(100%)]	285	262
Total	$2,528	
Short Fiscal Year Factor	335/365	
Maximum CCA*	$2,320	$2,321

*The $1 difference in the two amounts is due to rounding difference in the calculations.

Note 2 The work space in home costs would be calculated as follows:

Utilities For Home (Heat, Light, And Water)	$ 3,200
Mortgage Interest Paid	10,100
House Insurance	500
Property Taxes	4,300
Repairs And Maintenance For Home	2,600
Total	$20,700
Class 1 CCA [($426,000 - $150,000)(1/2)(4%)]	5,520
Total Costs For The Home	$26,220
Percentage Of Floor Space	18%
Subtotal	$ 4,720
Short Fiscal Year Factor	335/365
Deductible Home Work Space Costs	$ 4,332

Part C

There are two issues that should be discussed with Mr. Larson.

- As this problem asks for "minimum" net business income, CCA must be deducted on Mr. Larson's home. The problem with this is that, if he takes CCA, it could jeopardize the principal residence exemption on this property, resulting in the payment of taxes on a portion of the taxable capital gain that might arise on any future sale of the property, assuming real estate prices are increasing. This is discussed in more detail in Chapter 8.
- Although it is not relevant for this year, Mr. Larson should be aware that the deduction of work space in home costs cannot be used to create a loss in the future. However, any amount not deductible because it is greater than his income can be deducted in any subsequent year provided there is sufficient income from the same business in that year. This provides for an unlimited carry forward of unused work space in home costs (see IT-514, *Work Space in Home Expenses*).

TIF Solution Six - 8

Part A

The tax consequences resulting from the sale of the Honda can be calculated as follows:

January 1, 2016 UCC	$24,650
Disposition - Lesser Of:	
Capital Cost = $29,000	
Proceeds Of Disposition = $25,000	(25,000)
Negative Ending Balance	($ 350)
Recapture Of CCA	350
UCC - December 31, 2016	Nil

The $350 of recapture would be included in Maxine's net business income for 2016. No CCA would be deducted for Class 10. Note that, because the BMW cost more than $30,000, it would be allocated to a separate Class 10.1. This means that its acquisition would not eliminate the recapture in Class 10.

The maximum CCA deduction on the BMW would be calculated as follows:

Capital Cost (Limited To $30,000)	$30,000
One-Half Net Additions	(15,000)
Balance For CCA Purposes	$15,000
Rate	30%
Maximum CCA	$ 4,500

The net effect on income due to the two automobiles would be as follows:

Recapture Inclusion	$ 350
CCA	(4,500)
Operating Costs (Fully Deductible)	(12,300)
Decrease In Net Income For Tax Purposes	($16,450)

Part B

Because the Honda was used primarily (more than 50 percent) for employment purposes, it is eligible for the reduced standby charge and the alternative operating cost benefit calculation. This is not the case with the BMW sedan.

The minimum total benefit on the two vehicles would be calculated as follows:

Standby Charge:		
Honda [(2%)($29,000)(6)(8,000 ÷ 10,002*)]		$ 2,783
BMW - No Reduction [(2%)($105,000)(6)]		12,600
Total Standby Charge		$15,383
Operating Cost Benefit For Honda - Lesser Of:		
• [($2,783)(1/2)] = $1,392		
• [(8,000)($0.26)] = $2,080	$1,392	
Operating Cost Benefit For BMW		
[(19,000)($0.26)]	4,940	6,332
Minimum Total Benefit		$21,715

*[(6)(1,667)]

TIF Solution Six - 9

Market Determination - Two Possible Values

For tax purposes, the business can measure market using either replacement cost or net realizable value. These values would be as follows:

Replacement Cost [($16.75)(5,000)]	$83,750

Net Realizable Value [($18.30)(5,000)]	$91,500

While it is not an acceptable practice under GAAP, the CRA will accept the use of market values, without regard to their relationship to cost.

Cost Determination - Two Possible Values

In the determination of cost, taxpayers are permitted to use specific identification (this would not appear to be practical here), a First In, First Out (FIFO) assumption, or Average Cost.

Using the First In, First Out method, the appropriate value for the ending inventory would be determined as follows:

1,500 Units At $16.50	$24,750
3,200 Units At $21.42	68,544
300 Units At $20.25	6,075
5,000 Units At FIFO Cost	$99,369

Based on average cost, the ending inventory value would be calculated as follows:

Number Of Units	5,000
Average Cost [($297,644 ÷ 15,300)]	19.45
5,000 Units At Average Cost	$97,250

Lower Of Cost And Market - Four Possible Values

For tax purposes, the possible values here would be as follows:

Lower Of Replacement Cost And FIFO Cost	$83,750
Lower Of Replacement Cost And Average Cost	83,750
Lower Of Net Realizable Value And FIFO Cost	91,500
Lower Of Net Realizable Value And Average Cost	91,500

For accounting purposes, only the last two values would be acceptable.

TIF Solution Six - 10

Note To Instructors Some parts of this question involve issues that are not directly covered in the text (e.g., Item 7). By applying general principles, a student can arrive at an answer. However, you may not wish to have this type of question on your examinations.

1. Costs of obtaining financing are generally deductible, and consequently the payment to the Brazilian consultant would be deductible. However, as a financing cost, it would have to be deducted over five years at a rate of $240 per year.

2. Donations to registered Canadian charities can be deducted in the calculation of a corporation's Taxable Income. However, such contributions are not deductible in the calculation of Net Income For Tax Purposes. As business income is a component of Net Income For Tax Purposes, the contributions cannot be deducted at this stage.

3. The cost of the option on the land is a capital expenditure and cannot be deducted in the calculation of business income. As a capital expenditure, it will be added to the cost of any land acquired or, alternatively, if the option expires without an acquisition of land, the $2,500 will likely be considered a capital loss.

4. The costs of incorporating cannot be deducted. Rather, they represent an eligible capital expenditure, three-quarters of which will be added to the cumulative eligible capital account and deducted from income at a rate of 7 percent of the declining balance.

5. The cost of the franchise cannot be deducted during the current period. It is a capital expenditure that will be added to Class 14 and written off by the straight-line method over its 10 year life.

6. The landscaping costs are fully deductible as incurred. With respect to the cost of cancelling the lease, these amounts can only be deducted on a pro rata basis over the remaining term of the lease. The cost of the parking lot is a capital cost that will be added to Class 17 (miscellaneous assets including parking lots) and written off at a rate of 8 percent of the declining balance.

7. As the Company does not have legal title to the pedestrian bridge, it is not a capital asset. However, it should not be viewed as a current expense and, as a consequence, three-quarters of the cost will probably be allocated to cumulative eligible capital and deducted from income at a rate of 7 percent of the declining balance.

TIF Solution Six - 11

The required calculations would be as follows:

Net Business Income For Tax Purposes	$401,300
Item 1 - Maximum CCA (Note 1)	42,100
Item 1 - GAAP Amortization (Note 1)	(36,400)
Item 2 - Landscaping Costs (Note 2)	12,000
Item 3 - Web Site Maintenance (Note 3)	Nil
Item 4 - Class 8 Sale (Note 4)	1,600
Item 5 - U.S. Advertising (Note 5)	(5,500)
Item 6 - Business Meals And Entertainment (Note 6)	(6,000)
Item 7 - Theft (Note 7)	Nil
Item 8 - Class 10 Sale (Note 8)	4,159
Item 8 - Class 10 Sale (Note 8)	(8,552)
Item 9 - Donations (Note 9)	(4,200)
Item 10 - Soccer Uniforms (Note 10)	Nil
Item 11 - Ending Inventories (Note 11)	(5,000)
GAAP Based Net Income	$395,507

Note 1 The net adjustment is $5,700 added back.

Note 2 While landscaping costs can be deducted for tax purposes, if they have a life that extends beyond the current year, they must be treated as an asset under GAAP.

Note 3 It would appear that the costs of these services is reasonable. Given this, they can be deducted under both tax procedures and GAAP. No adjustment is required in determining GAAP based net income.

Note 4 For tax purposes, the $14,200 proceeds of disposition would be subtracted from Class 8. As there are still assets in the Class, as well as a positive balance in the Class at the end of the year, there are no tax consequences resulting from the disposition. However, under GAAP, a gain of $1,600 ($14,200 - $12,600) would have been recognized.

Note 5 While these costs could not be deducted for tax purposes, they would be deducted under GAAP.

Note 6 The $6,000 that was deducted for tax purposes would be one-half of the total of $12,000. Under GAAP, the remaining $6,000 can also be deducted.

Note 7 The stolen $4,300 can be deducted under both tax procedures and GAAP. No adjustment would be required in determining GAAP based net income.

Note 8 When the $15,000 proceeds of disposition is subtracted from Class 10 a balance of $4,159 ($19,159 - $15,000) remains in the Class. As there are no assets left in the Class, the tax figure was reduced by a terminal loss of $4,159. This must be added back. In contrast, under GAAP, the loss was $8,552 ($23,552 - $15,000). This must be deducted in place of the tax loss of $4,159.

Note 9 While charitable contributions cannot be deducted in determining net business income for tax purposes, they can be deducted under GAAP.

Note 10 The cost of the soccer uniforms would be a legitimate deduction for both tax and GAAP purposes. No adjustment is required in determining GAAP based net income.

Note 11 While market is an acceptable basis for inventory valuation using tax procedures, GAAP requires the use of lower-of-cost-or-market. Using this figure would reduce ending inventory values. This would increase GAAP based cost of sales and decrease GAAP based Net Income by $5,000 ($123,000 - $118,000).

TIF Solution Six - 12

The minimum net business income of Fairway Distribution would be calculated as follows:

Accounting Income As Reported	$273,000
Additions:	
Item 2 - Amortization	78,500
Item 3 - Cost Of Advertising In Foreign Newspaper (Note 1)	3,500
Item 3 - Donations To Charities (Note 2)	1,260
Item 3 - Cost Of Real Estate Appraisal (Note 3)	1,470
Item 3 - Cost Of Landscaping (Note 4)	5,260
Item 3 - Mrs. Fairway's Management Fee (Note 5)	123,000
Subtotal	$485,990
Deductions:	
Item 1 - Bad Debt Expense Adjustment (Note 6)	(4,200)
Item 2 - CCA (Given)	(123,600)
Net Business Income	$358,190

Note 1 In general, the cost of advertising in foreign media that is directed towards Canadian markets cannot be deducted for tax purposes. While there is an exception for foreign periodicals, it does not apply to foreign newspapers.

Note 2 Donations to charities cannot be deducted in the calculation of net business income. They will be the basis for a tax credit in the calculation of Tax Payable for Mr. Fairway.

Note 3 The cost of appraising a capital asset for purposes of sale is not deductible. Rather, it is an addition to the capital cost of the appraised asset.

Note 4 While landscaping costs related to business properties are deductible when incurred, the cost of improving non-business personal use property would not be.

Note 5 ITA 67 requires that business expenses be "reasonable in the circumstances". As Mrs. Fairway does not appear to do any work for the business, it would be difficult to view her management fee as reasonable. As a consequence, it would not be deductible.

Note 6 For tax purposes, the bad debt adjustment would be calculated as follows:

Last Year's Reserve	$15,000
Actual Write-Offs	(17,500)
This Year's Reserve	(19,200)
Total Deduction For Tax Purposes	($21,700)
Accounting Deduction (Actual Write-Offs)	17,500
Bad Debt Expense Adjustment	($ 4,200)

As $4,200 ($21,700 - $17,500) more than the amount that was written off for accounting purposes can be deducted for tax purposes, an adjustment is required. Note that the accounting procedures that were used in this case are not consistent with GAAP.

TIF Solution Six - 13

The minimum net business income of Morton Forms would be calculated as follows:

Accounting Income		$193,200
Additions:		
Amortization Expense	$69,300	
Reserve For Inventory Obsolescence (Note 1)	15,000	
Cost Of Advertising On A Foreign Television Station To The Canadian Market (Note 2)	9,600	
Unused Advertising Circulars [(3/4)($12,400)] (Note 3)	9,300	
Business Meals And Entertainment - Non-Deductible 50 Percent	11,000	
Charitable Donations (Note 4)	31,900	
Appraisal Costs On Land To Be Sold (Note 5)	4,200	150,300
		$343,500
Deductions:		
Landscaping Costs	($18,900)	
CCA	(94,200)	(113,100)
Net Business income		$230,400

Note 1 It would appear that this reserve has been established to reflect anticipated future declines in inventory values. Such amounts cannot be deducted for tax purposes.

Note 2 In general, when a Canadian enterprise places advertising directed at the Canadian market in foreign print or broadcast media, the costs of the advertising are not deductible. ITA 19.01 exempts certain foreign periodicals from this rule. However, the rule is still applicable to foreign broadcast media.

Note 3 Items such as advertising circulars would be viewed as a form of inventory. This means that the expense for the period would be limited to the amount distributed of $3,100 [(1/4)($12,400)].

Note 4 Donations to charities cannot be deducted in the calculation of net business income. They will be the basis for a tax credit in the calculation of Tax Payable for Ms. Morton.

Note 5 The appraisal costs on land to be sold must be added to the adjusted cost base of the asset.

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

Baseball Sponsorship This would be deductible as a promotional expense.

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

Mortgage Interest The interest would be deductible as the building is a capital asset of the business.

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

Fees Paid To Grandson Since the fees paid to Ms. Morton's grandson are reasonable when compared to those charged by a non-arm's length party, they are deductible.

TIF Solution Six - 14

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

Accounting Net Income	$147,000
Additions:	
Amortization Expense (Income Statement)	156,000
Income Tax Expense (Income Statement)	129,000
Item 2 - Non-Deductible Meals And Entertainment (50% of $15,000)	7,500
Item 3 - Contributions To Registered Charities	3,700
Item 4 - Articles Of Incorporation Amendment Costs	6,000
Item 6 - Bond Discount Amortization	2,500
Item 7 - Golf Club Membership Fees	3,400
Item 8 - Taxable Capital Gain On Sale Of Building [(1/2)($562,000 - $500,000)]	31,000
Item 8 - Gain on Land ($50,000 - $50,000)	Nil
Item 8 - Accounting Loss On Class 10 Assets	15,000
Item 9 - Interest On Late Income Tax Instalments	500
Subtotal	$501,600
Deductions:	
Item 1 - Landscaping Costs	(6,000)
Item 8 - Accounting Gain On Sale Of Building ($562,000 - $457,000) (Land ACB = $50,000)	(105,000)
Capital Cost Allowance (Note One)	(154,060)
Item 8 - Terminal Loss (Note One)	(8,000)
Write-Off Of CEC (Note Two)	(3,733)
Net Income For Tax Purposes	$224,807

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

January 1, 2016 Class 1 Balance		$400,000
Addition ($683,000 - $60,000)	$623,000	
Disposition - Lesser Of:		
• Proceeds = $562,000		
• Capital Cost = $500,000	(500,000)	123,000
One-Half Net Additions		(61,500)
CCA Base		$461,500
CCA At 4 Percent		(18,460)
One-Half Net Additions		61,500
January 1, 2017 UCC Balance		$504,540

January 1, 2016 Class 8 Balance	$575,000
Additions	126,000
One-Half Net Additions	(63,000)
CCA Base	$638,000
CCA At 20 Percent	(127,600)
One-Half Net Additions	63,000
January 1, 2017 UCC Balance	$573,400

January 1, 2016 Class 10 Balance	$45,000
Disposition - Lesser Of:	
• Proceeds = $37,000	
• Capital Cost = $93,000	(37,000)
Balance After Disposition	$ 8,000
Terminal Loss	(8,000)
January 1, 2017 UCC Balance	Nil

January 1, 2016 Class 13 Balance	$68,000
2016 CCA:	
2014 Expenditures ($50,000 ÷ 10 Years)	(5,000)
2015 Expenditures ($27,000 ÷ 9 Years)	(3,000)
January 1, 2017 UCC Balance	$60,000

Summary Of CCA Results (Not Required) The maximum 2016 CCA and January 1, 2017 UCC balances can be summarized as follows:

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

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

2015 Additions [(3/4)($70,000)]	$52,500
2015 CEC Amount At 7 Percent	(3,675)
Opening Balance, 2016	$48,825
Current Year Additions [(3/4)($6,000 Legal Costs)]	4,500
Balance Before CEC Amount	$53,325
2016 CEC Amount At 7 Percent	(3,733)
January 1, 2017 CEC Balance (Not Required)	$49,592

Other Notes

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

TIF Solution Six - 15

Carl's minimum net business income can be calculated as follows:

Carl Pomery
Statement Of Business Income
For Year Ending December 31, 2016

Revenues		
Revenue Collected	$123,000	
Billed Receivables (Note 1)		
Add Closing Balance	56,000	
Deduct Opening Balance	(48,000)	$131,000
Expenses		
Building Operating Costs	($ 22,000)	
Vehicle Operating Costs	(7,200)	
Vehicle Lease Payments (Note 2)	(5,775)	
Payments To Assistants	(24,000)	
Miscellaneous Office Costs	(4,500)	
Business Meals [(50%)($3,500)]	(1,750)	
CCA (Note 3)	(33,508)	
Terminal Loss For Class 10 (Note 4)	(2,060)	
CEC (Note 5)	(4,305)	(105,098)
Net Business Income		$ 25,902

Note 1 As Carl is a professional accountant he is eligible for the special rule under ITA 34 which allows him to recognize revenue on a billed basis. This means that he does not have to include his unbilled work-in-progress in his net business income.

Note 2 The car leasing costs would be wholly deductible as the monthly lease charge and the manufacturer's list price are within the prescribed limits.

Note 3 The total CCA deductible would be as follows:

Class 1 (Calculation Follows)	$14,520
Class 8 (Calculation Follows)	17,200
Class 50 (Calculation Follows)	688
Class 12 (Calculation Follows)	1,100
Total CCA	$33,508

Class 1 As the building is used 100 percent for non-residential purposes, it is eligible for the enhanced rate of 6 percent. This means that the maximum CCA would be:

Class 1 [($242,000)(6%)]	$14,520

Class 8 The required calculations are as follows:

Opening Balance		$72,000
Additions	$46,000	
Disposal - Lesser Of:		
• Proceeds = $18,000		
• Cost = $23,000	(18,000)	28,000
One-Half Net Additions		(14,000)
CCA Base		$86,000
Rate		20%
Class 8 CCA		$17,200

Class 50 The CCA on the new computer would be calculated as follows:

Class 50 [(1/2)(55%)($2,500)]	688

Class 12 The CCA on the applications software would be calculated as follows:

Class 12 [($2,200)(1/2)(100%)]	1,100

Note 4 As the only vehicle used by the business was disposed of during the year, there is no CCA for Class 10. However, as there is a balance left in the Class, there would be a terminal loss calculated as follows:

UCC Of The Class At The Beginning Of The Year	$16,660
Deduct: Dispositions During The Year - Lesser Of:	
• Capital Cost = $19,600	
• Proceeds Of Disposition = $14,600	(14,600)
Ending Balance With No Remaining Assets = Terminal Loss	$ 2,060

Note 5 Three-quarters of the $82,000 cost of the client list would be allocated to Cumulative Eligible Capital. The CEC deduction for the year would be $4,305 [($82,000)(3/4)(7%)].

TIF Solution Six - 16

The required calculations would be as follows:

Accounting Income (Loss)	
Before Taxes And Amortization Expense	($113,000)
Additions:	
Item 2 - Property Taxes On Fishing Lodge	1,100
Item 3 - Contributions To Charities (Note 1)	13,700
Item 6 - Lease Cancellation Payment (Note 2)	17,000
Item 8 - Insurance Premium (Note 3)	9,500
Item 12 - Renovation Costs (Note 4)	153,000
Item 13 - Wife's Convention Expenses	1,900
Item 14 - Bond Discount Amortization	950
Item 15 - Cost Of Amending Articles (Note 5)	3,600
Item 16 - Non-Deductible Portion Of Meals And Entertainment [(50%)($12,500)]	6,250
Net Business Income (Before CCA and CEC Deductions)	$ 94,000

Note 1 The contributions to registered charities will be deductible in the computation of Taxable Income, but not in the computation of income from a business. Charitable contributions are a deduction for corporations, although they are eligible for tax credit treatment for individuals.

Note 2 ITA 20(1)(z) requires that lease cancellation payments be amortized over the term of the lease remaining immediately before cancellation. The amount to be deducted is a pro rata calculation based on the number of days remaining subsequent to the cancellation. As the cancellation occurred on December 31, 2016, none of the amount would be deductible during the current year. The $17,000 would be deducted over the 7 years that would have remained of the lease term, at the rate of $2,429 per year. The fact that $5,000 of the amount had not been paid as of December 31, 2016 is not relevant.

Note 3 Life insurance premiums where the employer is the beneficiary are not considered to be incurred for the purpose of earning income and are therefore not deductible except where they are required by a creditor in relation to financing.

Note 4 These amounts serve to extend the life of the relevant asset and should be treated as capital expenditures. When they are added to the relevant UCC balances, they would result in increased CCA. However, the problem indicates that you do not have to consider CCA or CEC amounts.

Note 5 The payment to amend the articles of incorporation would be an eligible capital expenditure and three-quarters of the $3,600 would be added to the cumulative eligible capital amount. The Company would be able to deduct amortization of this amount. However, you have been instructed to ignore such deductions in this problem.

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

Item 1 If the damages relate to a transaction that produces business income, they are considered a business expense.

Item 4 Landscaping costs are fully deductible under ITA 20(1)(aa).

Item 5 Losses of this type, unless they result from the activity of senior officers or shareholders, are considered to be deductible as a normal cost of doing business.

Item 7 The bonus to the president would be deductible in 2016.

Item 9 Such appraisal costs are considered to be deductible as a normal cost of doing business.

Item 10 The $51,000 in management bonuses would be deductible in 2016. The 2015 bonuses would require no adjustments.

Item 11 The bad debts would be fully deductible.

Item 13 The $3,300 in costs associated with the president attending the convention would be deductible.

Item 15 Both the costs of defending against the breach of contract action, as well as the costs related to the income tax reassessment, would be fully deductible.

TIF Solution Six - 17

Part A - No Election

If the ITA 22 election is not made, the tax consequences for Gail Gates would be as follows:

Add: 2015 Reserve For Doubtful Debts	$15,000
2016 Income Inclusion	$15,000

While Gail has an allowable capital loss of $7,000 [(1/2)($263,000 - $249,000)], she will not be able to deduct this amount as she has had no capital gains in the previous three years and does not expect to have any in the current or subsequent years.

If the ITA 22 election is not made, the tax consequences to Mandy Portals would be as follows:

Proceeds Of Disposition (Amount Collected)	$251,000
Adjusted Cost Base	(249,000)
Capital Gain	$ 2,000
Inclusion Rate	1/2
2016 Income Inclusion	$ 1,000

Part A - Election

If the ITA 22 election is made, the tax consequences for Gail would be as follows:

Add: 2015 Reserve For Doubtful Debts	$15,000
Deduct: Business Loss ($263,000 - $249,000)	(14,000)
2016 Income Inclusion	$ 1,000

If the ITA 22 election is made, the tax consequences to Mandy would be as follows:

Add: Face Value - Price Paid ($263,000 - $249,000)	$14,000
Deduct: Actual Write-Offs ($263,000 - $251,000)	(12,000)
2016 Income Inclusion	$ 2,000

Part B

For Gail Gates, the ITA 22 election is clearly desirable, converting a $15,000 income inclusion into a $1,000 inclusion.

For Mandy Portals, the fact that actual collections ($251,000) exceed the estimated value of the Accounts Receivable on the date of the sale ($249,000), means that the ITA 22 election would not be desirable. It would double her income inclusion from $1,000 to $2,000.

TIF Solution Six - 18

Net Employment Income

The required calculations here are as follows:

Salary	$123,000
Additions	
Commissions	11,500
Car Allowance [($800)(12)]	9,600
Stock Option Benefit [($28 - $23)(500)]	2,500
Deductions	
RPP Contributions	(6,300)
Car Operating Costs [($9,300)(31,000 ÷ 46,000)]	(6,267)
Car CCA [($30,000)(30%)(1/2)(31,000 ÷ 46,000)]	(3,033)
Travel [($8,500 + $4,500 + (1/2)($2,000)]	(14,000)
Client Meals And Entertainment (See Notes)	Nil
Parking	Nil
Net Employment Income	$117,000

Notes:

- The fact the initial option price is below market value does not change the calculation of the employment income inclusion. However, when the shares are sold, Andrew will not be able to deduct one-half of the benefit in the determination of taxable income.
- The car allowance must be included in income as it is not based on kilometers of use.
- The base for the CCA on the car is limited to $30,000.
- Travel and client promotion costs of $18,300 [($8,500 + $4,500 + (1/2)($2,000 + $8,600)] could be deducted under ITA 8(1)(f). However, this deduction is limited to his commission income of $11,500. He is better off deducting the travel costs of $14,000 [$8,500 + $4,500 + (1/2)($2,000)] using ITA 8(1)(h). As discussed in the text, he cannot use both of the provisions in the same year.

Net Business Income

The required CEC calculations are as follows:

	CEC Balance	CEC Deductions
2015 CEC Addition [(3/4)($80,000)]	$60,000	
CEC Amount [($60,000)(7%)]	(4,200)	$4,200
Balance January 1, 2016 (As Given)	$55,800	
Proceeds From Sale [(3/4)($90,000)]	(67,500)	
Balance After Sale	($11,700)	$4,200

The negative balance in the CEC account after the sale is more than the CEC deduction. Given this, the income inclusion will be comprised of the following:

- $4,200 (the CEC deducted), plus
- $5,000 [(2/3)($11,700 - $4,200)].

The required calculations for net business income, which incorporate the preceding CEC calculations, are as follows:

Net Business Income Before CCA Or CEC (Given)	$189,000
Class 1 CCA [(4%)($472,200)]	(18,888)
Class 8 CCA [(20%)($143,300)]	(28,660)
Class 50 CCA [(55%)($12,500)]	(6,875)
CEC - Addition For Previous Deduction	4,200
CEC - Additional Income [(2/3)($7,500)]	5,000
Net Business Income	$143,777

Net Income For Tax Purposes And Taxable Income

Since there is no stock option benefit deduction, the required calculation here is as follows:

Net Employment Income	$117,000
Net Business Income	143,777
Net Income For Tax Purposes And Taxable Income	$260,777

Tax Payable

The required calculations are as follows:

Tax On First $200,000		$46,317
Tax On Next $60,777 ($260,777 - $200,000) At 33 Percent		20,056
Tax Before Credits		$66,373
Tax Credits:		
Basic Personal Amount (Andrew)	($11,474)	
Common-Law Partner Including FCA		
($11,474 + $2,121 - $4,500)	(9,095)	
Caregiver Including FCA - Bart (Note 1)	(6,788)	
Transfer Of John's Disability Credit	(8,001)	
EI	(955)	
CPP	(2,544)	
Canada Employment	(1,161)	
Transfer Of Tuition, Education And Textbook - Lesser Of:		
• $5,000		
• [$17,000 + (12)($400) + (12)($65)] = $22,580	(5,000)	
Medical Expenses (Note 2)	(17,579)	
Total Credit Base	($62,597)	
Rate	15%	(9,390)
Federal Tax Payable		$56,983

Note 1 Bart is eligible for both the infirm dependant over 17 and the caregiver tax credits. In these circumstances, ITA 118(4)(d), in effect, requires the use of the caregiver credit. Because Bart is infirm, and his income is below the threshold for the caregiver credit, Andrew can claim the full amount of the caregiver credit, including the family caregiver amount.

Note 2 The medical expense credit base would be calculated as follows:

Medical Expenses For Andrew, John, And Carl ($2,300 + $12,600 + $400)		$ 15,300
Reduced By The Lesser Of:		
• [(3%)($260,777)] = $7,823		
• 2016 Threshold Amount = $2,237		(2,237)
Balance Before Dependants 18 And Over		$ 13,063
Bart's Medical Expenses	$4,600	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)($2,800)] = $84	(84)	4,516
Total Medical Expense Claim		$17,579

TIF Solution Six - 19

Net Employment Income

The Net Employment Income component of Net Income For Tax Purposes would be calculated as follows:

Salary	$ 89,000
Additions	
Commissions	12,000
Automobile Benefit (Note 1)	1,140
Travel Allowance (Note 2)	Nil
Art Course Tuition Benefit (Note 3)	600
Near Cash Gift (Note 4)	400
Stock Option Benefit [(1,500)($61 - $52)]	13,500
Deductions	
RPP Contributions	(3,750)
Union Dues	(430)
Net Employment Income	$112,460

Note 1 The automobile benefit would be calculated as follows:

Standby Charge [(2/3)($459)(11)(8,500 ÷ 18,337)]	$1,560
Operating Cost Benefit - Lesser Of:	
• [($0.26)(8,500)] = $2,210	
• ($1,560 ÷ 2) = $780	780
Total Benefit Before Repayment	$2,340
Repayment	(1,200)
Automobile Benefit	$1,140

Note 2 As the travel allowance appears to be reasonable given his actual costs, it does not have to be included in Mr. Bowles' income and it is more advantageous for him not to do so. Correspondingly, he cannot deduct the travel costs incurred.

Note 3 Tuition for the marketing course would appear to be employment related and, as a consequence, would not be included in Mr. Bowles' employment income.

Note 4 While the non-cash gift for years of service does not have to be included in income, the $400 gift certificate, i.e. near cash gift, must be included.

Net Business Income

The Net Business Income component of Net Income For Tax Purposes would be calculated as follows:

Amounts Billed		$41,750
Unbilled Work In Progress (Note 5)		8,500
Total Inclusions		$50,250
Deductions:		
Office Rent (12 Months At $500)	($6,000)	
CCA (Note 6)	(2,934)	
Part Time Assistant	(5,725)	
Office Supplies	(347)	
Monthly Telephone Service	(312)	
Cell Phone Charges	(211)	
Meals And Entertainment [(1/2)($3,150)]	(1,575)	(17,104)
Net Business Income		$33,146

Note 5 While some professionals can elect under ITA 34 to use the billed basis for recognizing revenue, this approach is not available to management consultants.

Note 6 Maximum CCA would be calculated as follows:

Class 13 [(1/2)($12,000 ÷ 5*)]	$1,200
Class 8 [(1/2)(20%)($10,000)]	1,000
Class 50 [(1/2)(55%)($1,150)]	316
Class 12 [(1/2)(100%)($836)]	418
Total	$2,934

*With respect to the Class 13 amount, this is a straight line Class and it is subject to the half year rules. While the term of the lease is only three years, the deductible amount is the lesser of the capital cost divided by the term of the lease and one-fifth of the capital cost. In this case, the deduction is limited to one-half of one-fifth of the capital cost.

Net Income For Tax Purposes And Taxable Income

Mr. Bowles has Net Income For Tax Purposes and Taxable Income as follows:

Net Employment Income	$112,460
Net Business Income	33,146
Net Income For Tax Purposes	$145,606
Stock Option Deduction [($13,500)(1/2)]	(6,750)
Taxable Income	$138,856

Federal Tax Payable

The required calculations are as follows:

Tax On First $90,563		$16,075
Tax On Next $48,293 ($138,856 - $90,563) At 26 Percent		12,556
Tax Before Credits		$28,631
Tax Credits:		
Basic Personal Amount	($11,474)	
Spouse ($11,474 - $3,450)	(8,024)	
EI Premiums	(955)	
CPP Contributions	(2,544)	
Canada Employment	(1,161)	
Tuition Credit - Mr. Bowles (Note 7)	(600)	
Transfer Of Tuition, Education And Textbook - Lesser Of:		
• $5,000		
• [$9,800 + (8)($400) + (8)($65)] = $13,520	(5,000)	
Medical Expenses (Note 8)	(10,253)	
Total Credit Base	($40,011)	
Rate	15%	(6,002)
Charitable Donations (Note 9)		(385)
Political Contributions [(3/4)($275)]		(206)
Federal Tax Payable Before Refundable Credits		$22,188
Refundable Child Fitness Credit - Maximum [(15%)($500)]		(75)
Federal Tax Payable Before Refundable Credits		$22,113

Note 7 As Mr. Bowles included the reimbursement of the art course in his employment income as a taxable benefit, he can claim the tuition fee credit. As the course was only for two days, he would not be eligible for the part-time education or textbook credit.

Note 8 The amount of medical expenses that can be included is calculated as follows:

Medical Expenses For Martin, Sally, And Marie ($2,500 + $1,850 + $1,600)		$ 5,950
Lesser Of:		
• [(3%)($145,606)] = $4,368		
• 2016 Threshold Amount = $2,237		(2,237)
Balance Before Dependants 18 And Over		$ 3,713
Ellen's Medical Expenses	$6,540	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)(Nil)] = Nil	Nil	6,540
Total Medical Expense Claim		$10,253

Note 9 As Martin's Taxable Income does not exceed $200,000, none of the charitable donations credit will be based on the 33 percent tax rate. Given this, the credit is $385 [(15%)($200) + (29%)($1,425 - $200)].

Chapter Seven Test Item File Solutions

TIF Solution Seven - 1

1. The required two differences can be selected from the following differences which were described in the text:

   - When some types of property income are being earned, the deduction of capital cost allowance (CCA) cannot be used to create or increase a net loss for the period.
   - When property income is being earned by individuals, there is no requirement for a pro rata CCA reduction to reflect a short fiscal period.
   - When property income is being earned, the income attribution rules (see Chapter 9) are applicable. This is not the case when business income is being earned.
   - Certain expenses can be deducted against business income, but not property income. These include write-offs of cumulative eligible capital and convention expenses. In contrast, for individuals, there is a deduction for foreign taxes on property income in excess of 15 percent that is not available against foreign business income.

2. While other situations could be mentioned, the ones that are listed in the text are as follows:

   - Interest related to the acquisition of items for personal consumption (e.g., a loan to purchase a sail boat).
   - Interest related to the acquisition of assets which produce income that is only partially taxed (e.g., capital gains).
   - Interest related to the acquisition of assets which produce income that will not be taxed until a subsequent taxation year (e.g., gains on investments in land).

3. As discussed in Income Tax Folio S3-F6-C1, for an amount to be characterized as interest, three characteristics must be present:

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

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

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

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

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

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

8. While the purchaser must include all of the income received in his Net Income For Tax Purposes, he can then deduct the amount that was accrued at the date of purchase. While the question does not require this, we would note that the seller of the debt must include the same amount in his Net Income For Tax Purposes.

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

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

11. For eligible dividends, the gross up and tax credit procedures require that the dividends received be grossed up by 38 percent. The federal credit against tax payable is calculated as 6/11 of the amount of the gross up.

    For non-eligible dividends declared in 2016, the procedures require that the dividends received be grossed up by 17 percent. The federal credit against tax payable is calculated as 21/29 of the amount of the gross up. Note that these amounts will be subject to adjustment each year until 2019.

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

    - The adjusted cost base will be reduced by any return of capital that is included in the distributions that are received by the investor.
    - In those cases where the investor has chosen to reinvest distributions, the adjusted cost base will be increased by the amounts reinvested. As new units will be issued, this addition, when combined with the new total units, will create a new average cost for individual units.

13. If the mutual fund is organized as a corporation, all of its distributions will be taxed as dividends. With the exception of capital dividends, they will be grossed up and will generate a dividend tax credit. In most cases they will be eligible dividends.

    If the mutual fund is organized as a trust, its distributions will consist of the same types of income that were earned by the trust (eligible dividends, non-eligible dividends, capital gains, and foreign interest and dividend income). Some part of the distributions may also be a return of capital.

14. A stock dividend occurs when a corporation undertakes a pro rata distribution of shares to its existing shareholders without receiving any consideration in return.

    To the extent that the corporation has increased its paid up capital, it will be subject to tax as either an eligible or non-eligible dividend, subject to the usual gross up and tax credit procedures.

    With respect to the adjusted cost base of the investor's holding of shares, the amount that is taxed will be added to this value.

15. Tax legislation currently provides that only one-half of capital gains are to be included in Net Income For Tax Purposes. When a corporation recognizes a capital gain, only one-half is taxed at the corporate level. In the absence of a special provision, when the untaxed one-half is paid out as a dividend, it would be subject to tax. However, there is a special provision which allows capital dividends to be received on a tax free basis.

16. The full amount withheld will be added back in the determination of Taxable Income. Any amount that is withheld in excess of 15 percent will be deducted in the determination of Taxable Income. The amount withheld, to a maximum of 15 percent of the amount of foreign non-business income, will be applied as a credit against Canadian Tax Payable.

TIF Solution Seven - 2

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

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

3. True. IT Folio S3-F6-C1 makes it clear that the indirect use of the money is not relevant to the question of deductibility.

4. False. IT Folio S3-F6-C1 indicates that there is a presumption that common shares will pay dividends unless the securities have contractual terms that make such payments impossible.

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

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

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

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

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

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

TIF Solution Seven - 3

New For 2016/2017

1. B. Net Property Loss of $155 [(500)($0.50)(138%) - ($10,000)(5%)]

2. C. If an individual borrows $100,000 to invest in securities and the securities are later sold for $60,000, interest on the $100,000 will continue to be fully deductible provided the $60,000 is immediately invested in other securities.

3. D. If a new rental property is acquired, put into a separate CCA class, and is used more than 90 percent for non-residential purposes, it is eligible for an enhanced CCA rate of 10 percent.

4. B. All taxable dividends paid by Canadian controlled private corporations are non-eligible dividends.

5. C. Nil [(138%)($23,000(15%) - (38%)($23,000)(6/11)]

6. C. Business income received by an income trust will be distributed to investors as business income.

7. D. Pearlene will have foreign source net business income of $15,000 and a credit against Tax Payable of $3,000. [(€10,000)($1.50)] = $15,000; [(€2,000)($1.50)] = $3,000

Retained From Previous Editions

8. B. Net Property Income of $666 ($966* – 300).
*Dividend Income (2,000 x $0.35) = $700 x 138% = $966.

9. A. $2,352. [(50%)(1,000)($15 – $10) - $148*]
*Interest Expense = $10,148 – 10,000 = $148
[Calculated as: $10,000 x 6% x 90/365 = $147.95]

10. D. Net Property Loss of $102. ($100 x 138%) = $138 – $240 interest

11. D. Interest paid on funds borrowed to make interest-free loans to employees is not deductible.

12i. A. The accrual method.

12iiD. The receivable method.

12iii.E. Not allowed method ($1,200 interest would have to be accrued by the September 30, 2015 anniversary of the loan).

12iv. E. Not allowed method (interest would have to be accrued on the September 30, 2015 anniversary of the loan).

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

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

15. B. $0 in 2016 and $1,000 in 2017 ($20,000 x 5% = $1,000).

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

17. D. Jon will have to recognize nil in 2016 and $12,000 in 2017.

18. A. Individuals must accrue interest using the cash basis.

19. A. Provided the issuer is not in the business of lending money, issuing debt securities at a premium will normally reduce the after-tax cost of financing for the issuer.

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

21. B. Short fiscal period rule (only required for Business Income).

22. A. Cost of a new refrigerator (must be capitalized).

23. D. $500 for his labour (50 hours @ minimum wage of $10 per hour).

24. A. $4,660 ($11,200 – 6,000 – 540)

Calculations:
Rental revenue: [($1,400)(8) = $11,200
CCA: [(1/2)($300,000(4%)] = $6,000

25. B. 2016: $200,000 x 4% x 50% = $4,000, UCC = $100,000 - $4,000 = $196,000
2017: $196,000 x 4% = $7,840, Rental income = $8,000 - $7,840 = $160

26. D. Capital Dividends. (Capital Dividends are non-taxable and do not generate a dividend tax credit.)

27. B. The federal dividend tax credit is equal to 6/11 of the gross up on eligible dividends received.

28. C. Federal Tax Payable = Federal tax on grossed-up dividends minus the dividend tax credit.

29. D. $2,806 [($800)(138%) + ($600)(117%) + ($900 ÷ 90%)]

30. B. $260 [($900)(38%)(6/11) + ($600)(17%)(21/29)]

31. C. $5,066.

Taxes on the grossed up eligible dividends [(138%)($16,000)(29% + 17.5%)]	$10,267
Dividend tax credit [(38%)($16,000)(6/11 + 31%)]	(5,201)
Net Taxes	$ 5,066

32. D. $22,080 [(2%)($800,000)(138%)].

33. B. Increase of $560 [(500)($1.12)]

34. B. $1,128 [($1,200)(50%)(138%) + ($1,200)(50%)(50%)]

35. C. Income earned by the trust is not subject to income tax within the trust if it is distributed to the unitholders.

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

37. B. An increase in taxable income of $5,000 and a foreign tax credit of $500

38. B. $1,500 ($1,275 ÷ 85%) or 1,000 @ $1.50

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

40. A. $100 of interest income from Canadian bonds

TIF Solution Seven - 4

Exam Exercise Solution Seven - 1 (Discount Bonds)

Tax Consequences The tax consequences would be as follows:

Annual Deduction - 2016 Through 2021 [($1,250,000)(2%)]	$25,000
Maturity Amount	$1,250,000
Proceeds Of Sale	(1,150,000)
2021 Loss	$ 100,000

As the bonds were sold for less than 97 percent of their maturity amount and, in addition, the effective rate of 3.5 percent is more than four-thirds of the coupon rate [(2%)(4/3) = 2.7%], only one-half of the $100,000 loss, or $50,000 would be deductible. The total deduction for the six year period would be $200,000 [($25,000)(6) + $50,000].

Accounting Consequences The accounting consequences would be as follows:

Annual Interest Payment [($1,250,000)(2%)]	$25,000
Discount Amortization ($100,000 ÷ 6)	16,667
Annual Interest Expense - 2016 Through 2021	$41,667

Payment of the maturity amount in 2021 would have no tax consequences. Note that the total for the 6 year period would be $250,000 [(6)($41,667)], $50,000 more than could be deducted for tax purposes.

Exam Exercise Solution Seven - 2 (Discount Bonds)

Tax Consequences The tax consequences would be as follows:

Annual Deduction - 2016 Through 2018 [($800,000)(3%)]	$24,000
Maturity Amount	$800,000
Proceeds Of Sale	(770,000)
2018 Loss	$ 30,000

As the bonds are sold for less than 97 percent of their maturity value, only one-half of this loss would be deductible. The yield test cannot be applied as the problem does not give the effective yield on the bonds. The total deduction for the three year period would be $87,000 [(3)($24,000) + $30,000].

Accounting Consequences The accounting consequences would be as follows:

Annual Interest Payment [($800,000)(3%)]	$24,000
Discount Amortization ($30,000 ÷3)	10,000
Annual Interest Expense - 2016 Through 2018	$34,000

Payment of the maturity amount in 2018 would have no tax consequences. The total deduction for the 3 year period would be $102,000 [(3)($34,000)], $15,000 more than could be deducted for tax purposes.

Exam Exercise Solution Seven - 3 (Premium Bonds)

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

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

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

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

Exam Exercise Solution Seven - 4 (Premium Bonds)

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

Money Lender In this case, there would be an income inclusion of $300,000 ($1,200,000 - $900,000) in 2016. The interest deduction for the year would be $108,000 [(12%)($900,000)].

No Deliberate Premium In this case, the premium would have no immediate tax consequences and there would be no tax consequences when the bonds mature. The interest deduction for the year would be $108,000 [(12%)($900,000)]. Given that the bonds are paid off for less than the proceeds from their issuance, this result provides the issuer of the bonds with a tax free capital receipt of $300,000.

Deliberate Premium In this case, the premium would be amortized at the rate of $60,000 per year ($300,000 ÷ 5). This means the interest deduction for the year would be $48,000 ($108,000 - $60,000).

Exam Exercise Solution Seven - 5 (Annual Accrual Rules)

The total interest to be recorded on the instrument will be $33,600 [($80,000)(7%)(6 years)]. It will be allocated as follows:

Year	Interest Paid	Interest Reported
2016	Nil	Nil
2017	Nil	$ 5,600
2018	Nil	5,600
2019	$18,200	7,000
2020	Nil	4,200
2021	Nil	5,600
2022	15,400	5,600
Total	$33,600	$33,600

2016 As no anniversary date occurred and no interest was received during 2016, no interest will have to be included in Mr. Leiner's 2016 tax return.

2017 The first anniversary date occurs on May 31 and this requires the recognition of $5,600 [(7%)($80,000)] of interest.

2018 The second anniversary date occurs and this requires the recognition of an additional $5,600 of interest.

2019 The third anniversary date requires the recognition of $5,600 and, in addition, an $18,200 [(7%)($80,000)(3.25 Years)] payment is received. As $16,800 [(3)($5,600)] of this amount has been accrued on the three anniversary dates, only $1,400 of this amount will be added to income. This gives a total for the year 2019 of $7,000 ($5,600 + $1,400).

2020 The anniversary date will require recognition of $5,600. However, only $4,200 of this amount will be included as $1,400 was recognized in 2019.

2021 $5,600 will be recognized on the anniversary date.

2022 A payment of $15,400 [(2.75)($5,600)] will be received. As $9,800 ($4,200 + $5,600) of the amount received has been recorded on the two anniversary dates, the total for 2022 will be $5,600 ($15,400 - $9,800).

Exam Exercise Solution Seven - 6 (Annual Accrual Rules)

The total interest to be recorded on the instrument will be $10,000 [($50,000)(5%)(4 years)]. It will be allocated as follows:

Year	Interest Paid	Interest Reported
2016	Nil	Nil
2017	Nil	$ 2,500
2018	$ 6,250	3,750
2019	Nil	1,250
2020	3,750	2,500
Total	$10,000	$10,000

2016 As there is no anniversary date and no interest was received, no interest will have to be included in Ms. Lox's 2016 tax return.

2017 The first anniversary date occurs on March 31 of this year and requires the recognition of $2,500 [(5%)($50,000)] of interest in Ms. Lox's tax return.

2018 The second anniversary date occurs on March 31 of this year and requires the recognition of $2,500 [(5%)($50,000)] of interest in Ms. Lox's tax return. In addition, on September 30 of this year, an interest payment of $6,250 [(5%)($50,000)(2.5)] is received. As $5,000 of this amount has been recognized on anniversary dates, only an additional $1,250 ($6,250 - $5,000) must be recognized because of the payment. This gives a total of $3,750 ($2,500 + $1,250) to be included in Ms. Lox's 2018 tax return.

2019 The third anniversary date occurs on March 31 of this year and requires recognition of an additional $2,500 [(5%)($50,000)]. However, $1,250 of this amount was recognized in 2018, leaving only $1,250 to be included in Ms. Lox's 2019 return.

2020 The fourth anniversary date occurs on March 31 of this year and requires recognition of an additional $2,500 [(5%)($50,000)] of interest in Ms. Lox's tax return. In addition, a payment of $3,750 [(5%)($50,000)(1.5)] is received. As $1,250 of this amount has been recognized in 2019 and the remaining $2,500 must be recognized because of the fourth anniversary date, this payment does not require the recognition of any additional amounts of interest.

Exam Exercise Solution Seven - 7 (Accrued Interest At Transfer)

Mrs. White will have to include the full $4,000 received. However, under ITA 20(14) she is eligible for a deduction of $1,326 [($2,000)(120/181)], reflecting the interest that was accrued on the bonds at the time of her purchase. The net amount that will be included in her tax return is $2,674 ($4,000 - $1,326).

Exam Exercise Solution Seven - 8 (Accrued Interest At Transfer)

During 2016, Mr. Wexler will receive interest of $5,000 [(5%)($100,000)]. However, under ITA 20(14) he can deduct the $1,243 [($2,500)(90/181)] of interest that was accrued when the bonds were acquired on April 1, 2016. The net amount that will be included in his tax return is $3,757 ($5,000 - $1,243).

Exam Exercise Solution Seven - 9 (Rental Income)

Net rental income for Mr. Bodvin will be calculated as follows:

Rents	$32,000
Rental Expenses Other Than CCA	(27,500)
Rental Income Before CCA	$ 4,500
CCA (See Note)	(4,500)
Net Rental Income	Nil

Note Maximum CCA would be $6,660 [(1/2)(4%)($423,000 - $132,000 + $42,000)]. However, the maximum CCA that he can deduct will be limited to his net rental income before CCA of $4,500.

Exam Exercise Solution Seven - 10 (Rental Income)

Net rental income for Ms. Baxter will be calculated as follows:

Rents	$29,000
Rental Expenses Other Than CCA And Painting	(20,100)
Painting	(3,500)
Rental Income Before CCA	$ 5,400
CCA (See Note)	(5,400)
Net Rental Income	Nil

Note Maximum CCA would be $5,800 [(1/2)(4%)($385,000 - $95,000). However, the maximum CCA that can be deducted is limited to her net rental income before CCA of $5,400.

Exam Exercise Solution Seven - 11 (Eligible Dividend Income)

Eligible Dividends Received	$23,500
Gross Up (38%)	8,930
Taxable Dividends	$32,430
Combined Federal/Provincial Tax Rate (29% + 14%)	43%
Tax Before Credit	$13,945
Dividend Tax Credit [(6/11 + 25%)(38%)($23,500)]	(7,103)
Tax Payable	$ 6,842

The after tax retention is $16,658 ($23,500 - $6,842). Note that to calculate this amount, the taxes are deducted from the dividends received and not the grossed up taxable dividends.

Exam Exercise Solution Seven - 12 (Eligible Dividend Income)

Eligible Dividends Received	$10,200
Gross Up (38%)	3,876
Taxable Dividends	$14,076
Combined Federal/Provincial Tax Rate (33% + 16%)	49%
Tax Before Credit	$ 6,897
Dividend Tax Credit [(6/11 + 29%)(38%)($10,200)]	(3,238)
Tax Payable	$ 3,659

The after tax retention is $6,541 ($10,200 - $3,659). Note that to calculate this amount, the taxes are deducted from the dividends received and not the grossed up taxable dividends.

Exam Exercise Solution Seven - 13 (Non-Eligible Dividend Income)

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

Non-Eligible Dividends Received	$5,600
Gross Up (17%)	952
Taxable Dividends	$6,552
Combined Federal/Provincial Tax Rate (26% + 10%)	36%
Tax Before Credit	$2,359
Dividend Tax Credit [(21/29 + 38%)(17%)($5,600)]	(1,051)
Tax Payable	$1,308

The after tax retention is $4,292 ($5,600 - $1,308). Note that to calculate this amount, the taxes are deducted from the dividends received and not the grossed up taxable dividends.

Exam Exercise Solution Seven - 14 (Non-Eligible Dividend Income)

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

Non-Eligible Dividends Received	$14,200
Gross Up (17%)	2,414
Taxable Dividends	$16,614
Combined Federal/Provincial Tax Rate (26% + 7%)	33%
Tax Before Credit	$ 5,483
Dividend Tax Credit [(21/29 + 25%)(17%)($14,200)]	(2,352)
Tax Payable	$ 3,131

The after tax retention is $11,069 ($14,200 - $3,131). Note that to calculate this amount, the taxes are deducted from the dividends received and not the grossed up taxable dividends.

Exam Exercise Solution Seven - 15 (Income Trust Distributions)

Jeanine will include an additional $3,230 [(1,700)($1.90)] in Net Income For Tax Purposes. The adjusted cost base calculations are as follows:

Original Investment - Purchase Cost	$62,900
Reinvestment Of Distribution [(1,700)($2.75)]	4,675
Tax Free Return Of Capital [(1,700)($0.85)]	(1,445)
Adjusted Cost Base	$66,130

Original Investment - Number Of Units	1,700
Reinvestment Of Distribution ($4,675 ÷ $32)	146
Number Of Units	1,846

This will result in an average cost of $35.82 ($66,130 ÷ 1,846) per unit.

Exam Exercise Solution Seven - 16 (Income Trust Distributions)

Jerry will include an additional $1,250 [(2,500)($0.50)] in Net Income For Tax Purposes. The adjusted cost base calculations are as follows:

Original Investment - Purchase Cost	$30,000
Reinvestment Of Distribution [(2,500)($1.50)]	3,750
Tax Free Return Of Capital [(2,500)($1.00)]	(2,500)
Adjusted Cost Base	$31,250

Original Investment - Number Of Units	2,500
Reinvestment Of Distribution ($3,750 ÷ $12.50)	300
Number Of Units	2,800

This will result in an average cost of $11.16 ($31,250 ÷ 2,800) per unit.

Exam Exercise Solution Seven - 17 (Mutual Fund Distributions)

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

Exam Exercise Solution Seven - 18 (Mutual Fund Distributions)

The amount of the distribution would be $1,530 [(3,400)($0.45)]. Reinvestment of this amount at $5.10 per unit would result in Ariel receiving 300 additional units. Given this, her adjusted cost base per unit would be $5.01 [($17,000 + $1,530) ÷ (3,400 + 300)].

Exam Exercise Solution Seven - 19 (Stock Dividends)

The required calculations would be as follows:

Original Shares Held [(5%)(4,500,000)]	225,000
Stock Dividend Percentage	6%
New Shares Acquired	13,500
Per Share Addition To Paid Up Capital	$ 21
Eligible Stock Dividend Received	$283,500
Gross Up At 38 Percent	107,730
Taxable Eligible Dividend	$391,230

There would be a federal dividend tax credit of $58,726 [(6/11)(38%)($283,500)]. The $283,500 stock dividend would be added to the $4,275,000 [($19)(225,000)] original cost of the shares.

The adjusted cost base per share would be calculated as follows:

[($4,275,000 + $283,500) ÷ (225,000 + 13,500)] = $19.11

Exam Exercise Solution Seven - 20 (Stock Dividends)

The required calculations would be as follows:

Original Shares Held [(8%)(1,800,000)]	144,000
Stock Dividend Percentage	8%
New Shares Acquired	11,520
Per Share Addition To Paid Up Capital	$ 12
Stock Dividend Received	$138,240
Gross Up At 38 Percent	52,531
Taxable Eligible Dividend	$190,771

There would be a federal dividend tax credit of $28,653 [(6/11)(38%)($138,240)]. The $138,240 stock dividend would be added to the $1,584,000 [($11)(144,000)] original cost of the shares.

The adjusted cost base per share would be calculated as follows:

[($1,584,000 + $138,240) ÷ (144,000 + 11,520)] = $11.07

Exam Exercise Solution Seven - 21 (Foreign Source Income)

Part A If the foreign source income is non-business income, the credit against Tax Payable is limited to 15 percent of the foreign non-business income. Given this, the required calculations would be as follows:

Amount Received	$21,060
Withholdings [(22%)($27,000)]	5,940
Inclusion For Foreign Non-Business Income	$27,000
Deduction [(22% - 15%)($27,000)]	(1,890)
Increase In Taxable Income	$25,110
Federal Tax Rate	33%
Tax Payable Before Credit	$ 8,286
Foreign Tax Credit [(15%)($27,000)]	(4,050)
Federal Tax Payable	$ 4,236

Part B If the foreign source income is business income, the full amount of the withholdings can be used as a credit against Tax Payable. Given this, the required calculations are as follows:

Amount Received	$21,060
Withholdings [(22%)($27,000)]	5,940
Increase In Taxable Income	$27,000
Federal Tax Rate	33%
Tax Payable Before Credit	$ 8,910
Foreign Tax Credit (Amount Withheld)	(5,940)
Federal Tax Payable	$ 2,970

Exam Exercise Solution Seven - 22 (Foreign Source Income)

Part A If the foreign source income is non-business income, the credit against Tax Payable is limited to 15 percent of the foreign non-business income. In this case the withholding is at a rate of 20 percent [($34,000 - $27,200) ÷ $34,000]. Given this, the required calculations would be as follows:

Amount Received	$27,200
Withholdings [(20%)($34,000)]	6,800
Inclusion For Foreign Non-Business Income	$34,000
Deduction [(20% - 15%)($34,000)]	(1,700)
Increase In Taxable Income	$32,300
Federal Tax Rate	33%
Tax Payable Before Credit	$ 10,659
Foreign Tax Credit [(15%)($34,000)]	(5,100)
Federal Tax Payable	$ 5,559

Part B If the foreign source income is business income, the full amount of the withholdings can be used as a credit against Tax Payable. Given this, the required calculations are as follows:

Amount Received	$27,200
Withholdings [(20%)($34,000)]	6,800
Increase In Taxable Income	$34,000
Federal Tax Rate	33%
Tax Payable Before Credit	$ 11,220
Foreign Tax Credit (Amount Withheld)	(6,800)
Federal Tax Payable	$ 4,420

TIF Solution Seven - 5A

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

A. 7

B. 1

C. 4

D. 8

E. 3

F. 5

G. 9

H. 6

The two unused definitions are as follows:

Non-Eligible Dividends = 2

Interest Income = 10

TIF Solution Seven - 5B

For some terms there is both a 100 percent correct answer and an answer that is close. We have indicated the "close answer" in brackets.

The correct definitions for each of the listed key terms listed below.

A. 9 (not 7)

B. 1

C. 5

D. 11

E. 4

F. 6 (not 3)

G. 12

H. 8 (not 13)

The three unused definitions are as follows:

Non-Eligible Dividends = 2

Foreign Taxes Paid Credit = 10

Interest Income = 14

TIF Solution Seven - 6

Case A

The interest would be deductible as the direct use of the borrowed funds was to acquire the publicly traded securities which would (or should) produce income.

Case B

Since the proceeds exceed the borrowings, Mr. Tulee has complete flexibility with respect to linking, as long as the amount linked is less than or equal to the cost of the property. Any allocation totaling $50,000 would be acceptable.

Case C

Under ITA 20.1 (the disappearing source rules), the $220,000 balance will be deemed to be used to produce income. Therefore, she can continue to deduct the interest.

TIF Solution Seven - 7

Rental And Other Income

The required net rental income information can be calculated as follows:

	642 Kent Street	1256 Montreal Road	112 Lisgar Avenue	23 Durham Private
Rental Revenues	$63,000	$4,800	$5,000	$22,000
Property Taxes	(7,800)	(1,100)	(1,550)	(3,850)
Interest Charges	(11,700)	(1,450)	(650)	(11,500)
Other Expenses (Excluding CCA)	(12,750)	(900)	(2,500)	(8,700)
Terminal Loss On Furniture ($4,200 - $2,100)	N/A	(2,100)	N/A	N/A
Rental Income (Loss) Before CCA	$30,750	($ 750)	$ 300	($ 2,050)

The total pre-CCA income for the properties can be calculated as follows:

Net Rental Income:	
642 Kent Street	$30,750
1256 Montreal Road	(750)
112 Lisgar Avenue	300
23 Durham Private	(2,050)
Total Rental Income	$28,250

Proceed Of Disposition - 1256 Montreal Road	$65,000
Capital Cost	(37,000)
Capital Gain	$28,000
Inclusion Rate	1/2
Taxable Capital Gain	$14,000

CCA Deduction

As 1256 Montreal Road and 112 Lisgar each cost less than $50,000, they can be grouped into a single CCA Class 3. The opening UCC in this Class 1 would be $48,000 and, when the $37,000 capital cost of 1256 Montreal Road is deducted, a balance remains. This means that there will be no recapture on the sale of 1256 Montreal Road.

Maximum available CCA would be calculated as follows:

642 Kent Street [(5%)($412,000)]	$20,600
112 Lisgar Avenue [(5%)($48,000 - $37,000)]	550
23 Durham Private [(4%)($216,000)]	8,640
Total Available	$29,790

The deduction of CCA on Class 3 and/or Class 1 buildings cannot be used to create a rental loss and, as a consequence, it would be limited in this situation to the $28,250 of Rental Income Before CCA. This is less than the maximum available of $29,790, resulting in a situation in which there are various possibilities with respect to how much of the $28,250 will be deducted from the buildings in Classes 3 and how much will be deducted from the building in Class 1.

In general, CCA should be taken on assets with a lower rate first in order to leave more flexibility in the future. In this case, the maximum CCA of $8,640 should be taken on the Class 1 building, 23 Durham Private. As there are two Class 3 pools, both with a 5 percent rate, it would probably leave more future flexibility if the remaining $19,610 ($28,250 - $8,640) was taken from 642 Kent Street, the pool with the larger UCC.

Note that even though the Class 1 building generated a net rental loss of $2,050, CCA can still be taken on the class as there was rental income before CCA when all rental properties were considered.

TIF Solution Seven - 8

2015

The maximum CCA for 2015 would be calculated as follows:

	Class 1	Class 8
Addition	$690,000	$43,000
One-Half Net Additions	(345,000)	(21,500)
CCA Base	$345,000	$21,500
Maximum CCA:		
[(4%)($345,000)]	(13,800)	
[(20%)($21,500)]		(4,300)
Add: One-Half Net Additions	345,000	21,500
January 1, 2016 UCC	$676,200	$38,700

Net Rental Income for 2015 would be calculated as follows:

Rental Revenue	$63,600
Expenses Other Than CCA	(23,400)
Income Before CCA	$40,200
Class 1 CCA	(13,800)
Class 8 CCA	(4,300)
Net Rental Income	$ 22,100

Note that when an individual uses assets to produce property income (e.g., rental income), the full calendar year is considered to be the taxation year of the individual. This means that the short fiscal period rules are not applicable to Mr. Thorne.

2016

The terminal loss for Class 8 would be calculated as follows:

January 1, 2016 UCC	$38,700
Disposition - Lesser Of:	
• Cost = $43,000	
• Proceeds Of Disposition = $31,000	(31,000)
Balance With No Remaining Assets In The Class	$ 7,700
Terminal Loss	(7,700)
January 1, 2017 UCC - Class 8	Nil

The terminal loss will be deducted from the Class 8 UCC leaving a January 1, 2017 balance of nil.

The maximum CCA for 2016 would be $27,048 [(4%)($676,200)]. However, as the deduction of CCA cannot be used to create a loss, the actual amount deducted would be limited to $17,400, as shown in the calculation of Net Rental Income:

Rental Revenue	$54,500
Expenses Other Than CCA And Terminal Loss	(29,400)
Terminal Loss On Class 8 Assets	(7,700)
Income Before CCA	$17,400
CCA (Limited To Income Before CCA)	(17,400)
Net Rental Income	Nil

The January 1, 2017 UCC of the Class 1 building would be calculated as follows:

January 1, 2016 UCC	$676,200
2016 CCA Deducted	(17,400)
January 1, 2017 UCC - Class 1	$658,800

TIF Solution Seven - 9

2015

The maximum CCA for 2015 would be calculated as follows:

	Class 1	Class 8
Addition	$255,000	$12,800
One-Half Net Additions	(127,500)	(6,400)
CCA Base	$127,500	$ 6,400
Maximum CCA:		
[(4%)($127,500)]	(5,100)	
[(20%)($6,400)]		(1,280)
Add: One-Half Net Additions	127,500	6,400
January 1, 2016 UCC	$249,900	$11,520

Net Rental Income for 2015 would be calculated as follows:

Rental Revenue	$26,000
Expenses Other Than CCA	(10,900)
Income Before CCA	$15,100
Class 1 CCA	(5,100)
Class 8 CCA	(1,280)
Net Rental Income	$ 8,720

Note that when an individual uses assets to produce property income (e.g., rental income), the full calendar year is considered to be the taxation year of the individual. This means that the short fiscal period rules are not applicable to Mr. Taylor.

2016

The terminal loss for Class 8 would be calculated as follows:

January 1, 2016 UCC	$11,520
Disposition - Lesser Of:	
• Cost = $12,800	
• Proceeds Of Disposition = $10,400	(10,400)
Balance Before Terminal Loss	$ 1,120
Terminal Loss	(1,120)
January 1, 2017 UCC - Class 8	Nil

The terminal loss will be deducted from the Class 8 UCC leaving a January 1, 2017 balance of nil.

The maximum CCA for 2016 would be $9,996 [(4%)($249,900)]. However, as the deduction of CCA cannot be used to create a loss, the actual amount deducted would be limited to $9,100, as shown in the calculation of Net Rental Income:

Rental Revenue	$28,400
Expenses Other Than CCA And Terminal Loss	(18,180)
Terminal Loss On Class 8 Assets	(1,120)
Income Before CCA	$ 9,100
CCA (Limited To Income Before CCA)	(9,100)
Net Rental Income	Nil

The January 1, 2017 UCC of the Class 1 building would be calculated as follows:

January 1, 2016 UCC	$249,900
2016 CCA Deducted	(9,100)
January 1, 2017 UCC - Class 1	$240,800

TIF Solution Seven - 10

Part A - Bonds

The combined tax rates for the three sisters are 20 percent (15% + 5%), 37 percent (26% + 11%), and 49 percent (33% + 16%). Given these rates, the after tax returns on the bonds would be calculated as follows:

	Sarah (20%)	Sally (37%)	Suzanne (49%)
Interest [(4.5%)($15,000)]	$675	$675	$675
Federal/Provincial Tax Payable At 20, 37, And 49 Percent	(135)	(250)	(331)
After Tax Return	$540	$425	$ 344

Part B - Preferred Stock

The after tax returns resulting from an investment in the preferred stock begins with the calculation of the federal and provincial Tax Payable:

	Sarah (20%)	Sally (37%)	Suzanne (49%)
Dividends [(5.6%)($15,000)]	$ 840	$ 840	$ 840
Gross Up Of 38 Percent	319	319	319
Taxable Dividend	$1,159	$1,159	$1,159
Combined Rate (See Part A)	20%	37%	49%
Tax Before Dividend Tax Credit	$ 232	$ 429	$ 568
Dividend Tax Credit [(6/11 + 27%)($319)]	(260)	(260)	(260)
Tax Payable (Tax Savings)	($ 28)	$ 169	$ 308

Based on the preceding calculations of federal and provincial Tax Payable, the after tax returns on the preferred shares are calculated as follows:

	Sarah (20%)	Sally (37%)	Suzanne (49%)
Dividends [(5.6%)($15,000)]	$840	$840	$840
Tax Savings (Tax Payable)	28	(169)	(308)
After Tax Return	$868	$671	$532

Comparison

A comparison of the after tax rates of return can be made as follows:

	Sarah (20%)	Sally (37%)	Suzanne (49%)
After Tax Dividends	$868	$671	$532
After Tax Interest	(540)	(425)	(344)
Advantage Of Preferred Stock	$328	$246	$188

Recommendation

For each of the sisters, the preferred stock offers the superior after tax return. Note, however, that the advantage of the dividends declines as the taxpayer's tax rate increases. In addition, there is a somewhat higher level of risk associated with preferred shares.

TIF Solution Seven - 11

The major considerations in deciding between the two alternative investment strategies are the after tax return and the certainty of the related cash flows.

Guaranteed Investment Certificate As long as the certificate is purchased from a financial institution that is guaranteed by the federal government, there is virtually no risk that the principal or interest could be lost. Your combined federal and provincial tax rate for interest is 44 percent (29% + 15%). Based on this, the after tax retention on this investment would be as follows:

Interest [(3%)($250,000)]	$7,500
Tax Payable [(44%)($7,500)]	(3,300)
After Tax Return	$4,200

Common Stock Purchase If you invest the $250,000 in common stock, you will acquire 2,000 shares. With the dividend at $6.00 per share, the total eligible dividend will be $12,000. However, there is no guarantee that the stock will pay a dividend of $6.00 per share during the year. There is the possibility that more or less than $6.00 per share will be paid. In addition, the estimated market price of at least $135 on December 31, 2016 is also not certain. The price on that date could be higher or lower.

Assuming that the stock does pay $12,000 in dividends and you sell the shares for $135 per share on December 31, 2016, your after tax return on the investment is as follows:

Dividends Received	$12,000
Gross Up [(38%)($12,000)]	4,560
Taxable Dividends	$16,560
Taxable Capital Gain [(1/2)(2,000)($135 - $125)]	10,000
Taxable Income	$26,560
Tax Rate (29% + 15%)	44%
Tax Payable Before Dividend Tax Credit	$11,686
Dividend Tax Credit [(6/11 + 30%)($4,560)]	(3,855)
Tax Payable	$ 7,831

Dividends Received	$12,000
Capital Gain (100%)	20,000
Tax Payable	(7,831)
After Tax Return	$24,169

Conclusion Based purely on after tax returns, the common stock purchase is preferable as it provides an additional $19,969 ($24,169 - $4,200). However, as previously indicated, the common stock involves more risk and uncertainty. You will have to make a decision as to whether the additional $19,969 warrants the assumption of additional risk. Other factors which may influence your decision are as follows:

- The funds are locked into the investment certificate and can only be withdrawn prior to maturity at a severe interest penalty, if at all.
- The investment in common stock would give you more flexibility if you should require some of the funds before the end of the year. All or some portion of the stockholding could be sold during the year.
- Any dividends that are paid will be available for your use as at the payment date. The interest will not be available to you until maturity.

TIF Solution Seven - 12

Analysis

The major considerations in deciding between the two alternative investment strategies are the after tax return and the certainty of the related cash flows.

Income Trust Units The cash flows associated with investments in trust units are not guaranteed. However, the distributions made by these trusts tend to be fairly stable and, in general, involve less risk than dividends on common shares. If you select this investment, your $300,000 investment will acquire 15,000 units ($300,000 ÷ $20). The resulting cash distributions received and taxable income will be $13,050 [(12)($0.0725)(15,000)]. Based on this, your Tax Payable will be calculated as follows:

Trust Distributions = Taxable Income	$13,050
Tax Rate (22% + 10%)	32%
Tax Payable	$ 4,176

Your after tax return would be calculated as follows:

Trust Distributions	$13,050
Tax Payable	(4,176)
After Tax Retention - Income Trust	$ 8,874

Common Stock Purchase If you invest the $300,000 in the common stock, you will acquire 30,000 shares ($300,000 ÷ $10). The anticipated taxable income from these shares for the year is calculated as follows:

Eligible Dividends [(30,000)($0.05)]	$1,500
Gross Up [(38%)($1,500)]	570
Taxable Capital Gain [(1/2)(30,000)($10.50 - $10.00)]	7,500
Taxable Income	$9,570

Based on this figure, your Tax Payable would be calculated as follows:

Taxable Income	$9,570
Tax Rate (22% + 10%)	32%
Tax Payable Before Credits	$3,062
Dividend Tax Credit [(6/11 + 25%)($570)]	(453)
Tax Payable	$2,609

Your after tax return would be calculated as follows:

Pre Tax Cash Flow ($1,500 + $15,000)	$16,500
Tax Payable	(2,609)
After Tax Retention - Common Stock	$13,891

Conclusion

Using your estimates for investment returns, the better investment, based purely on after tax returns, is the common stock purchase. It provides an additional $5,017 ($13,891 - $8,874). However, the common stock investment involves more risk and uncertainty.

You will have to make a decision as to whether the additional $5,017 warrants the assumption of additional risk.

TIF Solution Seven - 13

Note To Instructors This problem is somewhat unrealistic in that, under the Canada/U.K. tax treaty, it is unlikely that there would be any amounts withheld on interest payments between the two countries. Note that this problem does not contain enough information to do a complete calculation of the foreign tax credit which is not covered until Chapter 11. We have assumed that the credit is equal to the maximum 15 percent of the amount withheld.

Taxable Income And Tax Payable

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

Interest On Term Deposit [(7%)(£200,000)($2.00)]	$28,000	
Excess Withholding (See Note)	(2,800)	$25,200
B&B Trust Distribution [($1.50)(8,000)]	$12,000	
Return Of Capital [($0.50)(8,000)]	(4,000)	8,000
Liberty Inc. Dividends [($1.60)(2,000)]	$ 3,200	
Dividend Gross Up [(38%)(3,200)]	1,216	4,416
Temple Capital Gain [($0.40)(2,500)]	$ 1,000	
Non-Taxable One-Half	(500)	500
Temple Eligible Dividends [($1.00)(2,500)]	$ 2,500	
Dividend Gross Up [(38%)($2,500)]	950	3,450
Temple Interest [($1.00)(2,500)]		2,500
Taxable Income		$44,066
Tax Rate (29% + 16%)		45%
Tax Before Credits		$19,830
Dividend Tax Credit [($1,216 + $950)(6/11 + 30%)]		(1,831)
Foreign Tax Credit - Note [(15%)(7%)(£200,000)($2.00)]		(4,200)
Tax Payable		$13,799

Note - Foreign Source Property Income As required, 100 percent of the foreign interest is included in Net Income For Tax Purposes. However, for individuals, the credit against Tax Payable that is provided under ITA 126(1) is limited to a maximum of 15 percent of the foreign source non-business income and the excess withholding is deducted. With the withholding rate at 25 percent, this deduction would be equal to $2,800 [(25% - 15%)(7%)(£200,000)($2.00)].

Adjusted Cost Base - B&B Trust

The reinvestment of the $12,000 [($1.50)(8,000)] distribution at $52 per unit would acquire an additional 230.77 units. After recognizing these changes, the adjusted cost base per unit would be as follows:

$30.13 [($240,000 + $12,000 - $4,000) ÷ (8,000 + 230.77)]

Adjusted Cost Base - Temple Small Cap

The reinvestment of the $6,000 [($2.40)(2,500)] distribution at $38 per unit would acquire an additional 157.89 units. After recognizing these changes, the adjusted cost base per unit would be as follows:

$39.88 [($100,000 + $6,000) ÷ (2,500 + 157.89)]

TIF Solution Seven - 14

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

Income From A Business Or Profession:		
Billed Revenues ($345,000 + $23,000 - $14,000)	$354,000	
Office Supplies And Office Expenses	(23,000)	
Rent	(60,000)	
Meals And Entertainment [(1/2)($18,000)]	(9,000)	
Convention Expenses (Note 1)	(2,400)	$259,600
Property Income:		
Income From Income Trust [($3.50 - $1.50)(2,500)]		5,000
Taxable Capital Gain (Note 2)		8,417
Minimum Net Income For Tax Purposes		$273,017

Note 1 Unless the scope of Ms. Smursch's business is likely to extend to this activity in the Middle East, the costs of the Beirut convention cannot be deducted.

Note 2 The adjusted cost base of the Realty Income Trust units would be calculated as follows:

Original Cost [(2,500)($43.00)]	$107,500
Reinvestment Of Distribution [(2,500)($3.50)]	8,750
Tax Free Return Of Capital [(2,500)($1.50)]	(3,750)
Adjusted Cost Base	$112,500

The taxable capital gain on the disposition of all the units would be calculated as follows:

Proceeds Of Disposition	$129,333
Adjusted Cost Base	(112,500)
Capital Gain	$ 16,833
Inclusion Rate	1/2
Taxable Capital Gain	$ 8,417

The distribution reinvestment resulted in 194.44 addition shares ($8,750 ÷ $45). However, this number is irrelevant as all of the units were sold.

TIF Solution Seven - 15

Part A(1) Net Income For Tax Purposes

Net Employment Income

Ms. Graham's Net Employment Income would be calculated as follows:

Gross Wages	$75,000
Life Insurance Premium	350
RPP Contributions	(3,500)
Net Employment Income	$71,850

Notes While the CPP contributions, EI premiums, and donations to the United Way will serve as the basis for credits against Tax Payable, they are not deductible in the determination of Net Employment Income. As the disability plan provides periodic benefits that compensate for lost employment income, the employer's contributions to the plan do not create a taxable benefit. The long-term disability premiums that Ms. Graham pays are not deductible, but can be used to offset future benefits.

Property Income - Investments

Ms. Graham's income from her investment portfolio is calculated as follows:

Interest On $200,000 Term Deposit [($200,000)(3.25%)] (Note 1)	$ 6,500
Interest On $20,000 Term Deposit (Note 1)	Nil
Eligible Dividends Received [(1,000)($24)]	24,000
Gross Up Of Eligible Dividends [(38%)($24,000)]	9,120
Non-Eligible Dividends Received [(100)($50)]	5,000
Gross Up Of Non-Eligible Dividends [(17%)($5,000)]	850
Foreign Dividends Before Withholding [(500)($2)]	1,000
Property Income - Investments	$46,470

Note 1 The interest on the $200,000 term deposit must be accrued to October 31, 2016, the first anniversary date of the debt instrument. As the $20,000 term deposit has not been outstanding for a full year, no interest accrual is required.

Property Income - Net Rental Income

Since the rental properties must be put into separate classes, there is recapture on the sale. The recapture and maximum CCA would be calculated as follows:

UCC Of Class 1 Property Sold	$90,450
Disposition - Lesser Of:	
• Capital Cost = $94,500 ($125,000 - $28,000 - $2,500)	
• Proceeds Of Disposition = $91,000 ($120,000 - $28,000 - $1,000)	(91,000)
Recapture Of CCA	($ 550)

Maximum Class 1 CCA On New Property (Including Improvements)	
[(4%)(1/2)($200,000 - $45,000 + $14,500 + $7,500)]	$3,540

Maximum Class 8 CCA

Opening UCC Balance		$2,145
Additions	$6,500	
Disposition - Lesser Of:		
• Capital Cost = $2,500		
• Proceeds Of Disposition = $1,000	(1,000)	5,500
One-Half Net Additions [(1/2)($5,500)]		(2,750)
CCA Base		$4,895
Rate		20%
Maximum Class 8 CCA		$ 979

Net rental income would be calculated as follows:

Rent Revenues	$16,150
Recapture Of CCA (See Preceding Calculation)	550
Rent Expenses Other Than Maintenance And CCA	(12,500)
Maintenance Costs ($1,200 + $500 + $2,000)	(3,700)
Net Rental Income Before CCA	$ 500
CCA (See Note)	(500)
Property Income - Net Rental Income	Nil

Note Since this is property income, there is no short fiscal year despite the purchase date of February 1. The maximum available CCA is $4,519 ($3,540 + $979). However, the amount that can be deducted is limited to $500, the net rental income prior to the deduction of CCA. This amount could be deducted from either Class 1 or Class 8. In general, when less than maximum CCA is to be taken, the deduction should be made from the class with the lowest rate (Class 1 in this example). However, when rental properties are sold, there is usually recapture on the building, reflecting the fact that such properties do not decline in value in proportion to CCA deductions. Given this possibility, it is preferable to take the CCA from Class 8, as used appliance dispositions rarely involve recapture.

Net Income For Tax Purposes

Total Net Income For Tax Purposes would simply be the sum of Net Employment Income and Net Property Income. There are no capital gains, other income, or other deductions.

Net Employment Income	$ 71,850
Property Income - Investments	46,470
Property Income - Net Rental Income	Nil
Net Income For Tax Purposes	$118,320

Part A(2) Taxable Income

There are no Taxable Income deductions available. As a consequence, Taxable Income is equal to Net Income For Tax Purposes.

Part A(3) Tax Payable

Federal Tax Payable would be calculated as follows:

Tax On First $90,563		$16,075
Tax On Next $27,757 ($118,320 - $90,563) At 26 Percent		7,217
Tax Before Credits		$23,292
Tax Credits:		
Basic Personal Amount (Caroline)	($11,474)	
Eligible Dependant - Grace		
($11,474 - $360)	(11,114)	
Caregiver - No FCA (Note 2)	(4,667)	
EI	(955)	
CPP	(2,544)	
Canada Employment	(1,161)	
Public Transit Pass [(10)($75)] (Note 3)	(750)	
First Time Home Buyers Credit	(5,000)	
Total Credit Base	($37,665)	
Rate	15%	(5,650)
Charitable Donations (Note 4)		(407)
Dividend Tax Credit On:		
Eligible Dividends [(6/11)(38%)($24,000)]		(4,975)
Non-Eligible Dividends [(21/29)(17%)($5,000)]		(616)
Foreign Tax Credit - Amount Withheld [(12%)($1,000)]		(120)
Tax Payable Before Refundable Credit		$11,524
Refundable Child Fitness Credit - Maximum [(15%)($500)]		(75)
Federal Tax Payable		$11,449

Note 2 Since Caroline's Dad has income below the caregiver credit threshold, she can claim the full credit for him. As he is not infirm, the family caregiver amount is not available for him.

Note 3 Caroline cannot claim a credit for the bus pass that she purchased for her father. Similarly, she cannot claim his age credit.

Note 4 As Caroline's Taxable Income is less than $200,000, the 33 percent tax rate is not relevant to the calculation of her charitable donations tax credit. Given this the credit is $407 [(15%)($200) + (29%)($1,500 - $200)].

The tuition paid for Grace's private high school does not qualify for the tuition tax credit. Further, Caroline cannot claim the tuition paid for her sister, Kristen, or her sister's medical costs as she is a non-resident.

Part B - Calculation Of Federal Marginal Tax Rates

Interest

The federal marginal tax rate on interest would be 26 percent. There are no special rates on interest income.

Eligible Dividends

The federal marginal tax rate on eligible dividends would be 15.2 percent {[(138%)(26%)] - [(6/11)(38%)]}

Non-Eligible Dividends

The federal marginal tax rate on non-eligible dividends is 18.1 percent {[(117%)(26%)] - [(21/29)(17%)]}

Investment Advice

Caroline pays the lowest rate of tax on eligible dividends. Investments that generate eligible dividends usually have a higher rate of return than those that generate interest income. However, the investments are usually riskier.

An additional consideration is that the source of the non-eligible dividends is a private corporation owned by a single family member. This would result in a higher risk investment than public company shares as the private company shares are less liquid.

Caroline will have to weigh the risks against the tax costs in order to determine the best combination of investment choices to meet her needs.

TIF Solution Seven - 16

Employment Income

Jezebel's net employment income would be calculated as follows:

Gross Wages	$71,500
RPP Contributions	(2,500)
Union Dues	(336)
Net Employment Income	$68,664

Property Income

Jezebel's property income would be calculated as follows:

Eligible Dividends Received	$15,400
Gross Up Of Eligible Dividends (38%)	5,852
Non-Eligible Dividends Received	2,600
Gross Up Of Non-Eligible Dividends [(17%)($2,600)]	442
Foreign Dividends Before Withholding ($13,600 ÷ 85%)	16,000
Interest	1,456
Property Income	$41,750

Net Business Income

Jezebel's net business income would be calculated as follows:

Net Cash Flow	$96,400
December 31 Billed Receivables	11,250
January 1 Billed Receivables	(8,400)
December 31 Work In Process (Note 1)	18,400
January 1 Work In Process	(12,600)
December 31 Accounts Payable	(7,485)
January 1 Accounts Payable	6,240
Non-Deductible Interest [($4,980 - (365)($10 Daily Maximum)]	1,330
Car Operating Costs (Already Deducted)	Nil
CCA ($14,641 + $3,961 + $4,500) (Note 2)	(23,102)
Net Business Income	$82,033

Note 1 Since the business involves management consulting, Jezebel cannot use the "billed basis of income recognition". As a result, she must include unbilled work in progress in her income.

Note 2 The CCA would be calculated as follows:

Class 1 CCA

January 1, 2016 UCC	$232,272
Additions (Improvements)	23,500
One-Half Net Additions	(11,750)
Base For CCA	$244,022
Rate	6%
CCA	$ 14,641

As the building was acquired new and was used 100 percent for non-residential purposes, it is eligible for the 6 percent CCA rate. The fact that it was the only building owned by the business would result in it automatically being allocated to a separate class, but it must remain in a separate Class 1 to continue to qualify for the 6 percent rate.

Class 8 CCA

January 1, 2016 UCC	$10,656
Additions	24,500
Disposals - Lesser Of:	
• Proceeds Of Disposition = $6,200	
• Capital Cost = $18,500	(6,200)
One-Half Net Additions [(1/2)($24,500 - $6,200)]	(9,150)
Base For CCA	$19,806
Rate	20%
CCA	$ 3,961

Class 10.1 CCA

As the cost of the car exceeds $30,000, the addition to Class 10.1 is limited to this value. The maximum deduction for 2016 would be $4,500 [(30%)(1/2)($30,000)].

Net Income For Tax Purposes And Taxable Income

There are no Taxable Income deductions available. As a consequence, Taxable Income is equal to Net Income For Tax Purposes.

Net Employment Income	$ 68,664
Property Income	41,750
Net Business Income	82,033
Pension Income [(12)($4,000)]	48,000
Net Income For Tax Purposes And Taxable Income	$240,447

Tax Payable

The *Income Tax Act* defines dependant as follows:

> **ITA 118(6)** Definition of "dependant" — ..."dependant" of an individual for a taxation year means a person who at any time in the year is dependent on the individual for support and is
>
> (a) the child or grandchild of the individual or of the individual's spouse or common-law partner; or ...

Although Norman has Net Income of $24,000, he is living with his parents, in a rehab program and going to university full time. This would indicate that he is dependent on Jezebel for support.

In the following calculation, Norman would not qualify for the caregiver tax credit as he is not infirm, but Jezebel can claim his medical expenses as he is a dependant and she has paid his medical expenses.

Tax Payable would be calculated as follows:

Tax On First $200,000		$46,317
Tax On Next $40,447 ($240,447 - $200,000) At 33 Percent		13,348
Tax Before Credits		$59,665
Tax Credits:		
Basic Personal Amount (Jezebel)	($11,474)	
Spouse ($11,474 - $15,200)	(Nil)	
Caregiver Including FCA - Samantha - Note 3	(6,788)	
Jezebel's Age Credit [$7,125 - (15%)($240,447 - $35,927)	Nil	
Jezebel's Pension Credit	(2,000)	
EI	(955)	
CPP	(2,544)	
Canada Employment	(1,161)	
Transfer Of Spouse's Age Credit (Note 4) ($7,125 - $3,726)	(3,399)	
Transfer Of Spouse's Pension Credit (Note 4)	(2,000)	
Transfer Of Samantha's Disability Credit	(8,001)	
Transfer Of Norman's Education Credits (Note 5)	(Nil)	
Medical Expenses (Note 6)	(19,150)	
Total Credit Base	($57,472)	
Rate	15%	(8,621)
Charitable Donations (Note 7)		(558)
Dividend Tax Credit On:		
Eligible Dividends [(6/11)(38%)($15,400)]		(3,192)
Non-Eligible Dividends [(21/29)(17%)($2,600)]		(320)
Foreign Tax Credit - Amount Withheld [(15%)($16,000)]		(2,400)
Federal Tax Payable		$44,574

Note 3 Samantha is eligible for both the infirm dependant over 17 credit and the caregiver credit. In such situations, ITA 118(4)(d) requires the use of the caregiver credit. As she is dependent on the Jane because of a physical or mental infirmity, she is also eligible for the family caregiver amount.

Note 4 Bernard's Net Income For Tax Purposes is below the threshold amount for the age credit, so his age credit will not be reduced. Since Bernard has no deductions from his Net Income For Tax Purposes, his Taxable Income is equal to $15,200.

In order to calculate how much of his age credit can be transferred, he must first reduce his federal Tax Payable to nil using a portion of his age credit calculated as follows:

Bernard's Taxable Income	$15,200
Basic Personal Amount	(11,474)
Age Credit Base Used By Bernard	$ 3,726

Bernard can transfer all of his pension income credit since his federal Tax Payable has been reduced to nil by the use of his age credit.

Note 5 Norman's education credits total $15,950 [(10)($400) + (10)($65) + $11,300]. While the maximum transfer is $5,000, this amount has to be reduced by the excess of Norman's Net Income For Tax Purposes over his basic personal credit. This amount would be $12,526 ($24,000 - $11,474), a value that would reduce the maximum transfer to nil.

Note 6
The claim for medical expenses is determined as follows:

Medical Expenses Of Jezebel And Bernard ($450 + $1,475)		$1,925
Reduced By The Lesser Of:		
• [(3%)($240,447)] = $7,213		
• 2016 Threshold Amount = $2,237		(2,237)
Balance Before Dependants 18 And Over		Nil
Samantha's Medical Expenses	$11,400	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)(Nil)] = Nil	Nil	$11,400
Norman's Medical Expenses	$ 8,470	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)($24,000)] = $720	(720)	7,750
Total Medical Expense Claim		$19,150

Note 7 Jezebel's charitable donations credit would be calculated as follows:

15 Percent Of $200	$ 30
33 Percent Of The Lesser Of:	
($1,800 - $200) = $1,600	
($240,473 - $200,000) = $40,473	528
29 Percent Of $1,800 - ($1,600 + $200)	Nil
Total Credit	$558

Chapter Eight Test Item File Solutions

TIF Solution Eight - 1

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

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

3. Government assistance for the acquisition of capital assets must be deducted from the adjusted cost base of the asset acquired. This is, in general, consistent with the accounting treatment of government assistance for the acquisition of capital assets.

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

5. The taxpayer subtracts the sum of the adjusted cost base plus selling costs, from the proceeds of disposition. The result is then multiplied by one-half resulting in a taxable capital gain (positive amounts) or an allowable capital loss (negative amount).

6. The adjusted cost base would be based on the average cost of the entire holding of the identical properties.

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

8. For tax purposes, warranty costs can only be deducted when costs are actually incurred. If no costs are incurred in the year of sale, no costs can be deducted against any income that arises in that period. When actual costs are incurred, they are treated as a capital loss. This means that only one-half of the costs can be deducted. In addition, such losses can only be deducted to the extent of capital gains, either in the period of incurrence or in a carry over period.

   In contrast, for accounting purposes, the enterprise must deduct the estimated cost of providing the warranty in the year in which the asset is sold. When actual costs are incurred, they are charged to the allowance that was established in the year of sale. If the actual costs are higher of lower than the estimate, there will be an adjustment which will be charged to income in the year that the warranty stops being applicable.

9. When a combination of land and buildings is sold, there will often be a capital gain on the land component, only one-half of which will be included in the selling taxpayer's Net Income For Tax Purposes. If the fair market value of the building is less than its UCC balance and the building is the last asset in its class, there will be a terminal loss on the building. This terminal loss will be 100 percent deductible and can be used to offset the one-half of the capital gain on the land that was included in the taxpayer's Net Income For Tax Purposes. This will, of course, tempt taxpayers to allocate a larger amount of the total proceeds to the land and a correspondingly smaller amount of the total proceeds to the building. The special rule in ITA 13(21.1)(a) increases the building proceeds to the point where any terminal loss will either be eliminated, or reduced to the point that it does not offset any capital gain on the land.

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

11. The enterprise will have a deductible loss of $4,000 [(€100,000)($0.04)]. The accounting treatment will not differ from the tax treatment.

12. If the option is exercised, its cost will be added to the adjusted cost base of the land. Alternatively, if it expires, its cost will be treated as a capital loss, one-half of which will be deductible only against taxable capital gains.

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

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

15. When an individual converts a principal residence to a rental property it is a change in use and, in the absence of an election, it is treated as a deemed disposition/reacquisition at fair market value. However, if the individual makes an election under ITA 45(2), he will be deemed not to have disposed of the property and it will continue to be eligible for the principal residence exemption. For up to four years, the property can continue to be designated as a principal residence for purposes of claiming the exemption. However, if the individual deducts CCA against his rental income, the election is rescinded. If the individual leaves the residence because of an employer required move, the election can be extended without limit, but the individual must return to that residence while still with the same employer.

16. The exceptions that are listed in the text are:

    - Real property situated in Canada.
    - Property belonging to a business that is carrying on business through a permanent establishment in Canada.
    - Excluded rights and interests (largely retirement savings balances).

17. An eligible small business corporation is a Canadian controlled private corporation that has substantially all (meaning more than 90 percent) of the fair market value of its assets devoted principally to an active business carried on primarily (meaning more than 50 percent) in Canada. The corporation's qualifying assets include its holdings of shares or debt in other eligible small business corporations. To be eligible for the ITA 44.1 provisions, the small business corporation and corporations related to it cannot have assets with a carrying value in excess of $50 million. Shares or debt of related corporations are not counted when determining the $50 million limit on assets.

18. Most business properties are insured for their replacement cost. When a property is destroyed by a natural disaster, it is a disposition with the insurance payments constituting the proceeds of disposition. As will often be the case, if the insurance proceeds exceed the cost of the destroyed property, the result will be a taxable capital gain. In addition, the required deduction from the relevant UCC classes may create one or more negative UCC balances. If the property is not replaced prior to the end of the taxation year, these negative balances will become recapture. Both the taxable capital gains and the recapture must be included in Net Income For Tax Purposes and, in the absence of the replacement property rules, could not be reversed.

19. There are two differences. The first difference relates to the type of property that is eligible. The rules apply to involuntary dispositions where capital property is lost, stolen, destroyed, or expropriated, without regard to its type. If the disposition is voluntary, only real property is eligible.

    The second difference relates to the timing of the replacement. For involuntary dispositions, the taxpayer has to replace the property within two years after the proceeds of disposition become receivable. When the disposition is voluntary, the time period is limited to one year.

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

TIF Solution Eight - 2

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

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

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

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

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

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

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

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

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

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

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

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

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

TIF Solution Eight - 3

New For 2016/2017

1. C. The lifetime capital gains deduction reduces the amount of capital gains included in Net Income For Tax Purposes.

2. B. $20,000. The calculations are as follows:

November 12 Sale	
Proceeds Of Disposition [(100)($120)]	$12,000
Adjusted Cost Base [(100)($220)]	(22,000)
Capital Loss	($10,000)
Disallowed Portion [($10,000)(80 ÷ 100)]	8,000
Allowed Portion	($ 2,000)

Cost Of 130 Shares	
November 18 Purchase [(80)($100)]	$ 8,000
Disallowed Loss	8,000
December 22 Purchase [(50)($80)]	4,000
Adjusted Cost Base	$20,000

3.D. If a portion of a property is sold, the adjusted cost base must be determined using the fair market value of the portion sold as a fraction of the total fair market value of the property.

4.D. Any capital gains reserve that is deducted in the current taxation year must be added back to income in the subsequent taxation year.

5. B. A capital gain of $50,000 and a terminal loss of nil.

The deemed proceeds for the building would be calculated as follows:

The Lesser Of:

• The FMV of the land and building	$950,000	
Reduced By The Lesser Of:		
• The ACB of the land = $250,000		
• The FMV of the land = $350,000	(250,000)	$700,000
• The Greater Of:		
• The FMV of the building = $600,000		
• The Lesser Of:		
The cost of the building = $800,000		
The UCC of the building = $650,000		$650,000

Based on this, the deemed proceeds for the land would be $300,000 ($950,000 - $650,000), resulting in a capital gain of $50,000 ($300,000 - $250,000). The terminal loss on the building would be reduced to Nil ($650,000 - $650,000).

6. D. If an individual owns only one real property, it is not necessary to file the Form T2091, *Designation Of A Property As A Principal Residence By An Individual*, in order to claim the principal residence exemption.

7 A. Losses on the disposition of personal use property can be deducted to the extent of gains on the disposition of personal use property.

8.D. $1,880.

The effect can be calculated as follows:

Proceeds Of Disposition [(1,000)(€12)($1.98)]	$23,760
Adjusted Cost Base [(1,000)(€10)($2.00)]	(20,000)
Capital Gain	$ 3,760
Inclusion Rate	1/2
Taxable Capital Gain	$ 1,880

9. A. If the option expires, Crystal will have a business loss of $5,000.

10. A. $16,000.

The maximum CCA is calculated as follows:

Opening UCC		Nil
Addition		
Cost ($850,000 - $400,000)	$450,000	
Bump Up [(1/2)($1,100,000 - $400,000)]	350,000	$800,000
One-Half Net Additions		(400,000)
Base For CCA		$400,000
Rate		4%
Maximum CCA		$ 16,000

11. B $16,667.
The total gain on property is $150,000 ($500,000 - $350,000). Rochelle can designate the property as her principal residence for the 3 years 2008 through 2010. In addition, she can elect to not have a deemed change in use for an additional 4 years, bringing the total to 7. Given that her total ownership period was 9 years, the exempt portion of the gain would be calculated as follows:

$$[\$150,000][(7 + 1) \div 9] = \$133,333$$

Based on this, Rochelle would have to recognize a gain of $16,667.

12. D. Nil
As both the residence and the apartment building are Taxable Canadian Property, no deemed disposition is required.

13. B. The use of the deferral provision will not affect the adjusted cost base of the replacement shares.

14. C. $1,398,539.
When the insurance proceeds were received in 2015, the Company would have to record a $150,000 ($1,650,000 - $1,500,000) capital gain, as well as recapture of $251,461 ($1,500,000 - $1,248,539). As the replacement cost of the new building exceeded the insurance proceeds, both of these amounts can be eliminated through an amended return. This will result in an addition to the UCC balance of $1,398,539 ($1,800,000 - $150,000 - $251,461).

Retained From Previous Editions

15. C. The favourable taxation of capital gains is designed to partially compensate businesses for the effects of inflation.

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

17. B. The tax treatment of gifts is different when the gift is made to a non-arm's length party rather than to an arm's length party.

18. B. CCA taken in previous years.

19. C. Since Carine's primary intent was to use the land in her business, the gain is a capital gain.

20. C. $275 for 2015, $90 for 2016
Smoke shares: 100 x ($28.00 – 22.50) = $550 x 50% = $275
2015 Mirrors shares: 100 x ($25.00 – 24.00) = $100 superficial loss
2016 Mirrors shares: (100 x $26.00) – [(100 x $23.20) + $100 superficial loss] = $180 x 50% = $90

21. C. When there is a partial disposition of land that is held as a capital asset, the adjusted cost base must be based on a proportionate share of the total area of the land. Proportionate allocation would not be appropriate if there are variances in the quality of the land (e.g., one part was a swamp that could not be used).

22. B. $156,250 - The maximum reserve that can be claimed is the lesser of:

- [($400,000 - $150,000)($250,000/$400,000)] = $156,250
- [($400,000 - $150,000)(20%)(4 - 0)] = $200,000

23. B. $78,125 - The maximum reserve that can be claimed is the lesser of:

- [($400,000 - $150,000)($125,000/$400,000)] = $78,125
- [($400,000 - $150,000)(20%)(4 - 1)] = $150,000

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

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

25. A. $400,000 - $160,000 = $240,000. [(1/2)($240,000 - $180,000)] = $30,000
    - (300,000/400,000)($240,000) = $180,000
    - (80%)($240,000) = $192,000

26. C. There is a capital gain on the land and a terminal loss on the building

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

    Home B owned 4 years (2013 to 2016)
    - 2013 and 2014 designated to Home A
    - 2015 and 2016 can be used for Home B

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

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

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

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

28. A. 2012 should be allocated to the cabin. Annual gain for the cabin is $6,000 ($30,000 / 5 years) which is greater than the annual gain for the chalet which is $5,000 ($30,000 / 6 years).

29. A. If a taxpayer owns two residences, and both are sold in the same year, the principal residence formula will eliminate the capital gain on only one of the residences.

30. C. $650 [(1/2)($1,500 - $200)]
    The net capital gain on listed personal property consisted of a $1,500 gain ($2,500 - $1,000) on the painting and a $200 loss ($1,000 - $1,200) on the stamp collection. There is no net capital gain on the personal use property as the outboard motor gain is eliminated by the $1,000 rule and the loss on the desk is not deductible.

31. C. $350 [($1,200 – 1,000) + (1,800 – 1,200) + (1,000 – 1,100)] x 50% = $350

32. C. An antique chair.

33. B. When a Canadian corporation issues foreign currency debt, a gain or loss will only be recognized when the debt is repaid.

34. B. If Nigel sells the option for $700, he will have an allowable capital loss of $150 [(1/2)($1,000 - $700)].

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

36. B. $8,750. Taxable capital gain on entire property: ($215,000 – 180,000) x 50% (one unit) = $17,500 x 50% = $8,750

37. B. $900. Deemed Cost [($80,000 x 50%) = $40,000] + Bump-up [($100,000 – 80,000) x 50% x 50% = $5,000]=$45,000. $45,000 x 50% (half year rule) x 4% = $900

38. C. The capital cost for CCA purposes will be $125,000. Since it is for personal use, there will be no CCA deducted.

39 B. $1,000,000 + (1/2)($1,400,000 - $1,000,000) = $1,200,000.

40. B. Susan must recognize a capital gain for tax purposes of $50,000 at January 1, 2016. Since she took CCA, the election is not available to her.

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

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

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

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

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

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

43. D. House in Ontario.

44. A. $680.

Deferred 2016 capital gain = $400 [(100)($32 - $28)].
ACB of Mouse shares = $2,800 [(80)($40) - $400].
Capital gain = $1,360 [(80)($52) - $2,800]. The taxable amount = $680 [(1/2)($1,360)].

45. A. The 2016 taxable capital gain is $250 and the deemed capital cost of the new equipment is $10,000

Taxable Capital Gain:
Lesser of a) $12,000 – 10,000 = $2,000
b) $12,000 – 11,500 = $500
x 50% = $250
Reversed Capital Gain = $2,000 – 500 = $1,500
Deemed Capital Cost = $11,500 – 1,500 = $10,000

46. D. Provided the replacement cost of the property is less than the proceeds of disposition, 100 percent of any recapture recognized as a result of an involuntary disposition can be reversed.

47. D. A warehouse was sold in December, 2014 with half the proceeds received at the time of sale and half of the proceeds receivable on January 1, 2016. A new warehouse was purchased in June, 2016.

TIF Solution Eight - 4

Exam Exercise Solution Eight - 1 (Government Assistance)

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

Exam Exercise Solution Eight - 2 (Government Assistance)

The capital cost of this Class 1 asset would be $2,100,000 ($2,600,000 - $500,000). Based on this, the maximum CCA in 2016 would be $42,000 [(4%)(1/2)($2,100,000)]. As the property is not new, it does not qualify for the enhanced CCA rates.

Exam Exercise Solution Eight - 3 (Superficial Loss)

The allowed portion of the loss would be calculated as follows:

Proceeds Of Disposition [(750)($13.75)]	$10,313
Adjusted Cost Base [(750)($21.50)]	(16,125)
Total Capital Loss	($ 5,812)
Disallowed Portion [(400)($21.50 - $13.75)]	3,100
Adjusted Capital Loss	($ 2,712)
Inclusion Rate	1/2
Allowable Capital Loss	($ 1,356)

The adjusted cost base of the acquired shares would be calculated as follows:

Purchase Price [(400)($12.15)]	$4,860
Disallowed Loss [(400)($21.50 - $13.75)]	3,100
Adjusted Cost Base	$7,960

Exam Exercise Solution Eight - 4 (Superficial Loss)

The allowed portion of the loss would be calculated as follows:

Proceeds Of Disposition [(1,000)($5)]	$ 5,000
Adjusted Cost Base [(800)($10) + (200)($12)]*	(10,400)
Total Capital Loss	($ 5,400)
Disallowed Portion [(200)($10.40* - $5)]	1,080
Adjusted Capital Loss	($ 4,320)
Inclusion Rate	1/2
Allowable Capital Loss	($ 2,160)

*Adjusted cost base of $10.40 ($10,400 ÷ 1,000) per share

The adjusted cost base of the acquired shares would be calculated as follows:

Purchase Price [(200)($1)]	$ 200
Disallowed Loss [(200)($10.40 - $5)]	1,080
Adjusted Cost Base	$1,280

Exam Exercise Solution Eight - 5 (Capital Gain On Depreciable Assets)

The required adjustments would be as follows:

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

Exam Exercise Solution Eight - 6 (Identical Properties)

The average cost of the shares involved in the first sale would be calculated as follows:

First Purchase [(700)($22.75)]	$15,925
Second Purchase [(410)($25.50)]	10,455
Total Cost	$26,380
Average Cost (26,380 ÷ 1,110)	$23.77

Given this, Mr. Park's taxable capital gain for 2015 is calculated as follows:

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

The average cost of the shares involved in the second sale would be calculated as follows:

Beginning Balance [(1,110 - 250)($23.77)]	$20,442
2016 Purchase [(925)($28.25)]	26,131
Total Cost	$46,573
Average Cost [$46,573 ÷ (1,110 - 250 + 925)]	$26.09

Given this, Mr. Park's taxable capital gain for 2016 is calculated as follows:

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

Exam Exercise Solution Eight - 7 (Identical Properties)

The total cost of the shares purchased in 2015 would be calculated as follows:

January, 2015 Purchase [(300)($4.75)]	$1,425
July, 2015 Purchase [(200)($5.25)]	1,050
Total Cost	$2,475
Average Cost ($2,475 ÷ 500)	$4.95

Based on this cost, the 2015 taxable capital gain would be calculated as follows:

Proceeds Of Disposition [(250)($5.40)]	$1,350.00
Adjusted Cost Base [(250)($4.95)]	(1,237.50)
Capital Gain	$ 112.50
Inclusion Rate	1/2
Taxable Capital Gain	$ 56.25

The total cost of the shares available for the December 2016 sale would be calculated as follows:

January 1, 2016 Balance [(250)($4.95)	$1,237.50
July, 2016 Purchase [(400)($5.50)]	2,200.00
Total Cost	$3,437.50
Average Cost ($3,437.50 ÷ 650)	$5.29

Based on this cost, the 2016 allowable capital loss would be calculated as follows:

Proceeds Of Disposition [(150)($4.80)]	$720.00
Adjusted Cost Base [(150)($5.29)]	(793.50)
Capital Loss	($ 73.50)
Inclusion Rate	1/2
Allowable Capital Loss	($ 36.75)

Exam Exercise Solution Eight - 8 (Warranties On Capital Assets)

For 2015, there will be a taxable capital gain of $26,500 [(1/2)($279,000 - $226,000)]. During 2016, there will be an allowable capital loss of $2,200 [(1/2)($4,400)]. This allowable capital loss will only be deductible in 2016 against 2016 taxable capital gains. Any loss that cannot be deducted in the current year is subject to the carry over provisions described in Chapter 11.

Exam Exercise Solution Eight - 9 (Warranties On Capital Assets)

In 2015, there will be a taxable capital gain of $28,000 [(1/2)($182,000 - $126,000)]. When the warranty costs are incurred in 2016, there will be an allowable capital loss of $1,200 [(1/2)($2,400)]. Any loss that cannot be deducted in the current year is subject to the carry over provisions described in Chapter 11.

Exam Exercise Solution Eight - 10 (Capital Gains Reserve)

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

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

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

Exam Exercise Solution Eight - 11 (Capital Gains Reserve)

The capital gain on the property would be $18,100 ($105,300 - $87,200).

At the end of 2015, the balance owing would be $100,000 ($105,300 - $5,300). Based on this, the 2015 reserve is the lesser of:

- [($18,100)($100,000 ÷ $105,300) $17,189
- [($18,100)(20%)(4 - 0)] $14,480

This means that the Net Income For Tax Purposes inclusion for 2015 would be $1,810 [(1/2)($18,100 - $14,480)].

At the end of 2016, the balance owing would be $50,000 ($100,000 - $50,000). Based on this, the 2016 reserve is the lesser of:

- [($18,100)($50,000 ÷ $105,300) $ 8,594
- [($18,100)(20%)(4 - 1)] $10,860

The taxable capital gain for 2016 would be calculated as follows:

2015 Reserve	$14,480
2016 Reserve	(8,594)
2016 Capital Gain	$ 5,886

The Net Income For Tax Purposes inclusion for 2016 would be $2,943 [(1/2)($5,886)].

At the end of 2017, all of the proceeds have been collected. Given this, no reserve can be deducted. However, the 2016 reserve will have to be added back to income, resulting in a Net Income For Tax Purposes inclusion of $4,297 [(1/2)($8,594)].

Exam Exercise Solution Eight - 12 (Bad Debts On Capital Assets)

For 2015, there will be an allowable capital loss of $8,000 [(1/2)($115,000 - $131,000)]. For 2016, there will be an allowable capital loss of $16,500 [(1/2)(Nil - $33,000)]. Both of these allowable capital losses will only be deductible against taxable capital gains.

Exam Exercise Solution Eight - 13 (Bad Debts On Capital Assets)

For 2015, there will be a taxable capital gain of $15,500 [(1/2)($213,000 - $182,000)]. In 2016, the uncollectible balance will create an allowable capital loss of $75,000 [(1/2)($150,000)]. He will be able to deduct this amount in 2016, to the extent of any taxable capital gains that are realized in that year. If the loss cannot be used in the current year, at least $15,500 can be carried back to 2015 and deducted against the taxable capital gain realized in that year (assuming he had no capital losses that year.) Any unused amount can be carried forward without time limit.

Exam Exercise Solution Eight - 14 (Special Rules For Sale Of Real Property)

In the absence of the special rules related to the sale of real property, there would be taxable capital gain of $10,000 [(1/2)($120,000 - $100,000)], and a terminal loss on the building of $3,000 [($350,000 - $7,000) - $340,000]. However, in these circumstances, ITA 13(21.1)(a) would require a deemed proceeds for the building to be calculated as follows:

The Lesser Of:		
• The FMV of the land and building	$460,000	
Reduced By The Lesser Of:		
• The ACB of the land = $100,000		
• The FMV of the land = $120,000	(100,000)	$360,000
• The Greater Of:		
• The FMV of the building = $340,000		
• The Lesser Of:		
The cost of the building = $350,000		
The UCC of the building = $343,000		$343,000

With the deemed proceeds for the building at $343,000, the terminal loss on the building would be reduced to nil [($350,000 - $7,000) - $343,000]. With the addition of $3,000 to the building proceeds, the land proceeds would be reduced to $117,000, thereby reducing the taxable capital gain to $8,500 [(1/2)($117,000 - $100,000)].

Exam Exercise Solution Eight - 15 (Sale Of Principal Residence)

The capital gain on each of the two properties is as follows:

	House	Cottage
Sales Price	$263,000	$197,000
Adjusted Cost Base	(186,000)	(105,000)
Capital Gain	$ 77,000	$ 92,000

Annual Gain - House ($77,000 ÷ 12)	$6,417
Annual Gain - Cottage ($92,000 ÷ 9)	$10,222

Given these amounts, the years 2009 through 2016 should be allocated to the cottage and the years 2005 through 2008 for the house. This gives the following gain reductions for the two properties:

Cottage {[$92,000][(8 + 1) ÷ 9]}	$92,000
City Home {[$77,000][(4 + 1) ÷ 12]}	$32,083

This will leave a minimum capital gain on the sale of the two properties of $44,917 ($92,000 - $92,000 + $77,000 - $32,083).

Exam Exercise Solution Eight - 16 (Sale Of Principal Residence)

The total capital gain on the two properties can be calculated as follows:

	City Home	Chalet
Sales Price	$214,000	$122,000
Adjusted Cost Base	(172,000)	(89,000)
Sales Commission At 6 Percent	(12,840)	(7,320)
Capital Gain	$ 29,160	$ 25,680

Annual Gain - City Home ($29,160 ÷ 14)	$2,083
Annual Gain - Chalet ($25,680 ÷ 8)	$3,210

Given these amounts, the years 2010 through 2016 should be allocated to the chalet. This leaves the years 2003 through 2009 for the Vernon house. This gives the following gain reductions for the two properties:

Chalet {[$25,680][(7 + 1) ÷ 8]}	$25,680
City Home {[$29,160][(7 + 1) ÷ 14]}	$16,663

This will leave a minimum capital gain of $12,497 ($25,680 - $25,680 + $29,160 - $16,663).

Exam Exercise Solution Eight - 17 (Personal Use Property)

The tax consequences would be as follows:

Personal Use Property		
Gain On Collector Car ($61,000 - $45,000)		$ 16,000
Loss On Antique Furniture (Personal Use Property)		Nil
Listed Personal Property		
Gain On Marble Sculpture ($13,000 - $1,000 floor)	$12,000	
Loss On Stamp Collection (See Note)	(12,000)	Nil
Capital Gain		$16,000
Inclusion Rate		1/2
Net Taxable Capital Gain		$ 8,000

Note The adjusted cost base of the marble sculpture is deemed to be $1,000 using the $1,000 floor rule. While there is a loss of $18,500 ($50,500 - $32,000), on the coin collection, it can only be deducted to the extent of the $12,000 capital gain on the sale of the sculpture because it is listed personal property. The balance of $6,500 ($18,500 - $12,000) can be carried back 3 years and forward 7 years.

Exam Exercise Solution Eight - 18 (Personal Use Property)

The results would be as follows:

Personal Use Property		
Gain On Sailboat ($56,000 - $42,000)		$14,000
Loss On Antique Sports Car (Personal Use Property)		Nil
Listed Personal Property		
Gain On Group Of Seven Painting ($145,000 - $142,000)	$3,000	
Loss On Coin Collection (See Note)	(3,000)	Nil
Capital Gain		$14,000
Inclusion Rate		1/2
Net Taxable Capital Gain		$ 7,000

Note While there is a loss of $6,500 ($11,500 - $18,000), on the coin collection, it can only be deducted to the extent of the $3,000 capital gain on the sale of the painting. The balance of $3,500 ($6,500 - $3,000) can be carried back 3 years and forward 7 years.

Exam Exercise Solution Eight - 19 (Foreign Currency Gains And Losses)

The taxable capital gain on the sale is calculated as follows:

Proceeds Of Disposition [(300)(B$85)(C$0.72)]	$18,360
Adjusted Cost Base [(300)(B$51)(C$0.70)]	(10,710)
Capital Gain	$ 7,650
Inclusion Rate	1/2
Taxable capital Gain	$ 3,825

None of this gain qualifies under ITA 39(2), so there would be no $200 exemption.

Exam Exercise Solution Eight - 20 (Foreign Currency Gains And Losses)

At the time of the January sale, Mr. Steller will have a taxable capital gain, calculated as follows:

Proceeds Of Disposition [(500)(£32)($1.80)]	$28,800
Adjusted Cost Base [(500)(£20)($2.00)]	(20,000)
Capital Gain	$ 8,800
Inclusion Rate	1/2
Taxable Capital Gain	$ 4,400

When the currency is converted in December, Mr. Steller will have a taxable capital gain calculated as follows:

Proceeds Of Conversion [(500)(£32)($1.90)]	$30,400
Adjusted Cost Base Of Currency [(500)(£32)($1.80)]	(28,800)
Foreign Exchange Gain	$ 1,600
Exclusion (Permitted To Individuals)	(200)
Foreign Exchange Gain Subject To Tax	$ 1,400
Inclusion Rate	1/2
Foreign Exchange Taxable Capital Gain	$ 700

Exam Exercise Solution Eight - 21 (Change In Use - CCA On Rental Property)

The required calculations are as follows:

Cost Of Building ($142,000 - $22,000)		$120,000
FMV At Change In Use ($242,000 - $22,000)	$220,000	
Cost	(120,000)	
Gain	$100,000	
Bump Up	1/2	50,000
Subtotal		$170,000
One-Half Net Additions		(85,000)
Base For CCA		$ 85,000
Rate		4%
Maximum CCA		$ 3,400

As this is less than the $4,800 in net rental income, this full amount can be deducted. The first year rules are applicable as the property was not used to produce business or property income prior to the change in use. However, the short fiscal period rules do not apply to an individual earning property (rental) income.

Exam Exercise Solution Eight - 22 (Change In Use - ACB, UCC And CCA)

There would be a taxable capital gain resulting from the change in use as follows:

Deemed Proceeds Of Disposition ($136,400 - $20,000)	$116,400
Adjusted Cost Base ($57,000 - $20,000)	(37,000)
Capital Gain	$ 79,400
Inclusion Rate	1/2
Taxable Capital Gain	$ 39,700

Cost Of Building ($57,000 - $20,000)		$37,000
FMV At Change In Use ($136,400 - $20,000)	$116,400	
Cost	(37,000)	
Gain	$79,400	
Bump Up	1/2	39,700
Subtotal		$76,700
One-Half Net Additions		(38,350)
Base For CCA		$38,350
Rate		4%
Maximum 2016 CCA		$ 1,534
January 1, 2017 UCC ($76,700 - $1,534)		$75,166

Exam Exercise Solution Eight - 23 (Emigration)

There would be a deemed disposition on his departure, leaving him liable for the taxes on a $13,000 [(1/2)($56,000 - $30,000)] taxable capital gain.

Exam Exercise Solution Eight - 24 (Emigration)

There would be a deemed disposition on her departure, leaving her liable for the taxes on a $3,500 [(1/2)($52,000 - $45,000)] taxable capital gain.

Exam Exercise Solution Eight - 25 (Deferral Of Small Business Gains)

The capital gain is $500,000 ($1,100,000 - $600,000). As the $940,000 cost of the replacement shares is less than the $1,100,000 proceeds of disposition, the permitted deferral is calculated as follows:

[($500,000)($940,000 ÷ $1,100,000)] = $427,273

This leaves the adjusted cost base of the Quint Ltd. shares at $512,727 ($940,000 - $427,273).

Exam Exercise Solution Eight - 26 (Deferral Of Small Business Gains)

The required calculations are as follows:

Capital Gain ($985,000 - $895,000)	$90,000
Maximum Deferral [($90,000)($800,000 ÷ $985,000)]	$73,096

This reduction will be allocated to the two investments as follows:

	Barby Shares	Ken Shares
Cost Of Investments	$200,000	$600,000
Deferral:		
[($73,096)($200,000 ÷ $800,000)]	(18,274)	
[($73,096)($600,000 ÷ $800,000)]		(54,822)
Adjusted Cost Base	$181,726	$545,178

Exam Exercise Solution Eight - 27 (Involuntary Dispositions)

As the replacement of the building did not occur until 2016, there will be a taxable capital gain and recapture in 2015:

Insurance Proceeds	$1,000,000
Capital Cost	(815,000)
Capital Gain	$ 185,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 92,500

UCC	$648,275
Disposition - Lesser Of:	
Capital Cost = $815,000	
POD = $1,000,000	(815,000)
Negative Ending Balance = Recapture	($166,725)

Using the ITA 44(1) election, the amended capital gain for 2015 will be nil, the lesser of:

- The reported gain of $185,000
- Nil - The excess of the proceeds of disposition over the cost of the new Building.

With the ITA 13(4) election, the amended 2015 recapture is as follows:

January 1, 2015 UCC		$648,275
Deduction:		
Lesser Of:		
• Proceeds Of Disposition = $1,000,000		
• Capital Cost = $815,000	$815,000	
Reduced By The Lesser Of:		
• Normal Recapture = $166,725		
• Replacement Cost = $1,075,000	(166,725)	(648,275)
Amended 2015 Recapture		Nil

These amended figures will be reflected in the values for the new building as follows:

Cost Of New Building	$1,075,000
Capital Gain Deferred By Election	(185,000)
Deemed Capital Cost	$ 890,000
Recapture Deferred By Election	(166,725)
UCC - December 31, 2016	$ 723,275

These amounts are $75,000 more than the old capital cost and UCC. This reflects the $75,000 ($1,075,000 - $1,000,000) over and above the insurance proceeds that the Company spent on replacing the building.

Exam Exercise Solution Eight - 28 (Involuntary Dispositions)

The results in 2015 would be as follows:

Proceeds Of Insurance	$20,000
Capital Cost	(18,000)
Capital Gain	$ 2,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 1,000

January 1, 2015 UCC	$12,000
Lesser Of:	
Capital Cost Of $18,000	
Proceeds Of Disposition Of $20,000	(18,000)
Negative Ending Balance = Recapture	($ 6,000)

Using the ITA 44(1) election, the amended capital gain for 2015 will be nil, the lesser of:

- The reported gain of $2,000
- Nil - The excess of the proceeds of disposition over the cost of the new equipment.

With the ITA 13(4) election, the amended 2015 recapture is as follows:

January 1, 2015 UCC		$12,000
Deduction:		
Lesser Of:		
• Proceeds Of Disposition = $20,000		
• Capital Cost = $18,000	$18,000	
Reduced By The Lesser Of:		
• Normal Recapture = $6,000		
• Replacement Cost = $20,000	(6,000)	(12,000)
Amended 2015 Recapture		Nil

Subsequent to the application of these elections, the tax values for the equipment would be as follows:

Cost Of New Equipment	$20,000
Capital Gain Deferred By Election	(2,000)
Deemed Capital Cost Of New Equipment	$18,000
Recapture Deferred By Election	(6,000)
UCC At December 31, 2016	$12,000

Exam Exercise Solution Eight - 29 (Voluntary Dispositions)

There is no capital gain as the proceeds of disposition equal the total cost of the property. However, as the replacement did not occur until 2016, there will be recapture of CCA in 2015 calculated as follows:

UCC	$ 250,000
Lesser Of:	
Capital Cost = $1,100,000	
Proceeds Of Disposition = $1,100,000	(1,100,000)
Negative Ending Balance = Recapture Of CCA	($ 850,000)

Using the ITA 13(4) election in 2016, the amended 2015 recapture can be calculated as follows:

January 1, 2015 UCC		$250,000
Deduction:		
Lesser Of:		
• Proceeds Of Disposition = $1,100,000		
• Capital Cost = $1,100,000	$1,100,000	
Reduced By The Lesser Of:		
• Normal Recapture = $850,000		
• Replacement Cost = $1,400,000	(850,000)	(250,000)
Amended 2015 Recapture		Nil

This will result in tax values for the new building and 2016 CCA as follows:

Capital Cost	$1,400,000
Recapture Reversal	(850,000)
UCC	$ 550,000
One-Half Net Additions [(1/2)($550,000)]	(275,000)
CCA Base	$ 275,000
Rate	4%
2016 CCA	$ 11,000

TIF Solution Eight - 5A

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

A. 1

B. 9

C. 3

D. 4

E. 10

F. 7

G. 8

H. 2

The two unused definitions are as follows:

Disposition = 5

Personal Use Property = 6

TIF Solution Eight - 5B

For some terms there is both a 100 percent correct answer and an answer that is close. We have indicated the "close answer" in brackets.

The correct definitions for each of the listed key terms listed below.

A. 1 (not 5)

B. 13

C. 3

D. 6 (not 11)

E. 14 (not 10)

F. 9

G. 12 (not 4)

H. 2

The two unused definitions are as follows:

Disposition = 7

Personal Use Property = 8

TIF Solution Eight - 6

Part A

The total cost of the 1,222 shares remaining on December 31, 2016 would be $17,077. This is calculated in the following table:

Acquisition Or Sale Date	Shares Purchased (Sold)	Cost Per Share	Total Cost	Average Cost/Share
March 2010	650	$11.00	$ 7,150	
September, 2011	922	13.00	11,986	
May, 2013	480	17.00	8,160	
Subtotal	2,052		$27,296	$13.30
November, 2013 Sale	(610)	$13.30	(8,113)	
July, 2016	240	18.00	4,320	
Subtotal	1,682		$23,503	$13.97
October, 2016	(460)	$13.97	(6,426)	
December 31, 2016 Balances	1,222		$17,077	

Part B

The average cost of the shares sold during July, 2016 would be calculated as follows:

April, 2015 Purchase [(2,200)($12)]	$26,400
December, 2015 Purchase [(1,450)($17)]	24,650
Total Cost	$51,050
Average Cost ($51,050 ÷ 3,650)	$13.99

Given this average cost, the taxable capital gain on the July, 2016 sale of shares would be calculated as follows:

Proceeds [(2,840)($22)]	$62,480.00
Cost [(2,840)($13.99)]	(39,731.60)
Capital Gain	$22,748.40
Inclusion Rate	1/2
Taxable Capital Gain	$11,374.20

TIF Solution Eight - 7

2016 Results

For this year, Ms. Houde will have a taxable capital gain calculated as follows:

Proceeds Of Disposition	$6,000,000
Adjusted Cost Base	(3,500,000)
Capital Gain	$2,500,000
Inclusion Rate	1/2
Taxable Capital Gain	$1,250,000

As no provision can be made for the provided warranty and Ms. Houde has chosen not to use a reserve, this full amount will have to be included in her Net Income For Tax Purposes.

2017 Results

During this year, Ms. Houde will have to include the $250,000 [(5%)($6,000,000 - $1,000,000)] of interest in her Net Income For Tax Purposes.

Receipt of the 2017 principal payment has no tax consequences.

The $400,000 payment to the developer will result in a $200,000 [(1/2)($400,000)] allowable capital loss. If she has no other capital losses during 2017, this amount can be carried back to be used against taxable capital gains in the previous 3 years, including any unused balance of the $1,250,000 taxable capital gain that was recognized on the original sale.

Any loss that is not carried back can be carried forward indefinitely and applied against future capital gains. (Loss carry overs are covered in Chapter 11.)

2018 Results

During this year, the only tax effect will be the inclusion of the $200,000 [(5%($6,000,000 - $1,000,000 - $1,000,000)] of interest received in her Net Income For Tax Purposes.

2019 Results

At the beginning of 2019, the balance of the loan is $4,000,000. With only $1,000,000 of this being recovered from the bankruptcy, Ms. Houde will have a 2019 allowable capital loss of $1,500,000 [(1/2)($4,000,000 - $1,000,000)]. If she has other capital gains in 2019, this can be applied to reduce these amounts. If not, the $1,500,000 can be carried back to be used against taxable capital gains in the previous 3 years, including any unused balance of the $1,250,000 taxable capital gain that was recognized on the original sale.

Any loss that is not carried back can be carried forward indefinitely and applied against future capital gains. (Loss carry overs are covered in Chapter 11.)

Net Effect

Ms. Houde has collected only $3,000,000 of the total principal amount. In addition, this amount has been reduced to $2,600,000 by the required warranty payment. If she had originally sold the property for this amount, she would have had an allowable capital loss of $450,000 [(1/2)($2,600,000 - $3,500,000)]. Note that this is the same amount that has resulted from the preceding transactions:

2016 Taxable Capital Gain	$1,250,000
2017 Allowable Capital Loss	(200,000)
2019 Allowable Capital Loss	(1,500,000)
Net Tax Effect Of Sale	($ 450,000)

TIF Solution Eight - 8

The capital gain on the two tracts of land would be calculated as follows:

	Tract A	Tract B
Proceeds Of Disposition	$127,000	$106,000
Adjusted Cost Base	(71,000)	(87,000)
Capital Gain	$ 56,000	$ 19,000

2016 Solution

At the end of 2016, the proceeds not due for Tract A is $110,000 ($127,000 - $17,000). The corresponding figure for Tract B is $74,000 ($106,000 - $32,000).

The minimum taxable capital gain to be included in Ms. Helm's income for 2016 would be calculated as follows:

	Tract A	Tract B
Total Capital Gain	$ 56,000	$ 19,000
Maximum Reserve For 2016:		
Tract A - Lesser Of:		
[($56,000)($110,000 ÷ $127,000)] = $48,504		
[($56,000)(20%)(4)] = $44,800	(44,800)	
Tract B - Lesser Of:		
[($19,000)($74,000 ÷ $106,000)] = $13,264		
[($19,000)(20%)(4)] = $15,200		(13,264)
Subtotal	$ 11,200	$ 5,736
Inclusion Rate	1/2	1/2
2016 Inclusion	$ 5,600	$ 2,868

2017 Solution

At the end of 2017, the proceeds not due for Tract A is $85,000 ($110,000 - $25,000). The proceeds not due for Tract B are not changed from 2016.

The minimum taxable capital gain to be included in Ms. Helm's income for 2017 would be calculated as follows:

	Tract A	Tract B
2016 Reserve Added Back	$ 44,800	$ 13,264
2017 Reserve:		
Tract A - Lesser Of:		
[($56,000)($85,000 ÷ $127,000)] = $37,480		
[($56,000)(20%)(3)] = $33,600	(33,600)	
Tract B - Lesser Of:		
[($19,000)($74,000 ÷ $106,000)] = $13,264		
[($19,000)(20%)(3)] = $11,400		(11,400)
Subtotal	$ 11,200	$ 1,864
Inclusion Rate	1/2	1/2
2017 Inclusion	$ 5,600	$ 932

TIF Solution Eight - 9

Capital Gain

The taxable capital gain on the disposition would be calculated as follows:

Proceeds Of Disposition	$895,000
Adjusted Cost Base	(135,000)
Selling Costs [(4%)($895,000)]	(35,800)
Capital Gain	$724,200
Inclusion Rate	1/2
Taxable Capital Gain	$362,100

Reserve Limits

Under ITA 40(1)(a)(iii), the amount that can be deducted as a capital gains reserve is equal to the lesser of:

- [(Capital Gain)(Proceeds Not Yet Due ÷ Total Proceeds)]
- [(Capital Gain)(20%)(4 - Number Of Preceding Years Ending After Disposition)]

The second part of this formula serves to require that at least 20 percent of the gain be recognized in the year of disposition and each subsequent year, without regard to the pattern of cash collected.

Part A

The reserve percentage under the two components of ITA 40(1)(a)(iii) would be as follows:

Year	Proceeds Not Yet Due	20 Percent Formula
2016	90%	80%
2017	80%	60%
2018	70%	40%
2019	60%	20%
2020	50%	Nil

In this case, the formula calculation provides the lowest figure in each of the 5 years. Using this as the basis for the reserve will result in the recognition of $144,840 [(20%)($724,200)] of the gain in each of the five years. The taxable amount in each year will be $72,420, for a total of $362,100 over the five years 2016 through 2020.

Part B

In this case, the reserve percentage components would be as follows:

Year	Proceeds Not Yet Due	20 Percent Formula
2016	50%	80%
2017	40%	60%
2018	30%	40%
2019	20%	20%
2020	10%	Nil

For the years 2016 through 2018, the proceeds not yet due calculation provides the lowest figure. Based on this, the minimum reserve for the three years would be calculated as follows:

- 2016 [($724,200)(50%)] = $362,100
- 2017 [($724,200)(40%)] = $289,680
- 2018 [($724,200)(30%)] = $217,260

	2016	2017	2018
Capital Gain	$724,200	N/A	N/A
Previous Year's Reserve		$362,100	$289,680
New Reserve	(362,100)	(289,680)	(217,260)
Capital Gain	$362,100	$ 72,420	$72,420
Inclusion Rate	1/2	1/2	1/2
Taxable Capital Gain	$181,050	$ 36,210	$36,210

For the year 2019, both components of the ITA 40(1)(a)(iii) have the same percentage.

2018 Reserve Added To Income	$217,260
2019 Reserve [($724,200)(20%)]	(144,840)
Capital Gain	$ 72,420
Inclusion Rate	1/2
Taxable Capital Gain For 2019	$ 36,210

For the year 2020, the 20 percent formula provides the lower percentage.

2019 Reserve Added To Income	$144,840
2020 Reserve [($724,200)(0%)]	Nil
Capital Gain	$144,840
Inclusion Rate	1/2
Taxable Capital Gain For 2020	$ 72,420

As shown in the following table, at this point the entire $362,100 taxable capital gain has been recognized:

Year	Gain Recognized
2016	$181,050
2017	36,210
2018	36,210
2019	36,210
2020	72,420
Total	$362,100

TIF Solution Eight - 10

As the ownership period varies for the two properties, the total gains must be converted to annual amounts. The Kelowna home was owned for 20 years (1997 through 2016) and the Ottawa home was owned for 12 years (2005 through 2016).

Given this, the annual gains are as follows:

	Kelowna Home	Ottawa Home
Proceeds Of Disposition	$897,000	$534,000
Adjusted Cost Base	(623,000)	(426,000)
Total Capital Gain	$274,000	$108,000
Divided By Years Owned	20	12
Annual Gains	$ 13,700	$ 9,000

As the annual gain is larger on the Kelowna home, qualifying years should be designated to that property first. Because of the plus one in the exemption formula, it will only take 19 years to completely eliminate the gain on this property. This leaves 1 year to be designated to the Ottawa home.

The required calculations would be as follows:

	Kelowna Home	Ottawa Home
Total Capital Gain	$274,000	$108,000
Exemption:		
Kelowna Home (1997 to 2015)		
{[$274,000][(19 + 1) ÷ 20]}	(274,000)	
Ottawa Home (2016)		
{[$108,000][(1 + 1) ÷ 12]}		(18,000)
Capital Gain	Nil	$ 90,000
Inclusion Rate	N/A	1/2
Taxable Capital Gain	Nil	$ 45,000

This gives a total taxable capital gain on the two properties of $45,000.

TIF Solution Eight - 11

Classification Of Property

All of the items sold are personal use property. However, if they can be classified as "listed personal property", their tax treatment will be different. Under ITA 54, listed personal property consists of the following items.

(i) print, etching, drawing, painting, sculpture, or other similar work of art,
(ii) jewelry,
(iii) rare folio, rare manuscript, or rare book,
(iv) stamp, or
(v) coin.

The Paul Borduas painting, as well as the Hemingway first edition clearly fall into the listed personal property classification. The Bentley and the Chris Craft clearly do not.

The classification of the fountain pen collection is not clear. The issue is whether a pen can be considered jewelry (and not a writing implement) as there are fountain pens that cost as much as $100,000 and are made from precious metals and stones.

The dictionary definition of jewel includes "a precious possession". However, the definition of jewelry is more narrow, referring to "ornaments for personal adornment". Whether something that is displayed on one's desk would be considered personal adornment would be debatable, but the fact that Mr. Howard always "wears" the pens prominently would favour the jewelry classification.

In the solution which follows, we have classified the pens as jewelry. However, we recognize that this classification could be subject to challenge.

Effect On Net Income For Tax Purposes

The overall amount to be included in Net Income For Tax Purposes can be calculated as follows:

Personal Use Property (Note 1)		
Gain On Antique Boat ($62,000 - $45,000)	$17,000	
Loss On Bentley	Nil	$17,000
Listed Personal Property		
Gain On First Edition ($31,000 - $12,000)	$19,000	
Gain On Painting ($132,000 - $128,000)	4,000	
Total Listed Personal Property Gains	$23,000	
Loss On Pens (Note 2)	(23,000)	Nil
Net Capital Gains		$17,000
Inclusion Rate		1/2
Addition To Net Income For Tax Purposes		$ 8,500

Note 1 Unless an item of personal use property can be classified as listed personal property, losses on its disposition cannot be deducted. However, gains on such property are taxable, without regard to the classification.

Note 2 The total loss on the pen collection is $29,000 ($13,000 - $42,000). However, the current year deduction is limited to the $23,000 in gains on listed personal property. The remaining $6,000 ($29,000 - $23,000) can be carried back 3 years and forward 7 years to be applied against gains on listed personal property that have occurred in previous years or may occur in subsequent years.

TIF Solution Eight - 12

2014 Results

The purchase of shares with newly acquired Swiss Francs will have no effect on Net Income For Tax Purposes in this year.

2015 Results

The total dividend received is SF5,500 [(5,000)(SF1.10)]. This amount will be converted to $7,425 [(SF5,500)($1.35)] and included in Mr. Franklin's 2015 Net Income For Tax Purposes. Since Matterhorn is not a taxable Canadian corporation, its dividends are not eligible for the gross up and tax credit procedures.

2016 Results

The taxable capital gain on the sale of securities would be calculated as follows:

	SF Amount	Rate	Translated
Proceeds Of Disposition [(5,000)(SF23)]	SF115,000	$1.38	$158,700
Adjusted Cost Base [(5,000)(SF25)]	(SF125,000)	$1.25	(156,250)
Capital Gain (Loss) On Sale Of Securities	(SF 10,000)		($ 2,450)
Inclusion Rate			1/2
Allowable Capital Loss			($ 1,225)

At the time of conversion, Mr. Franklin will have SF5,500 from the 2015 dividend, plus SF115,000 from the sale of shares, a total of SF120,500. A capital loss will result from their conversion, calculated as follows:

Proceeds Of Conversion [(SF120,500)($1.34)]		$161,470
Adjusted Cost Base		
Dividend Proceeds [(SF5,500)($1.35)]	$ 7,425	
Share Proceeds [(SF115,000)($1.38)]	158,700	(166,125)
Capital Gain (Loss) On Foreign Exchange		($ 4,655)
ITA 39(1.1) Reduction Of Capital Loss		200
Net Capital Loss		($ 4,455)
Inclusion Rate		1/2
Allowable Capital Loss		($ 2,228)

The total allowable capital loss of $3,453 ($1,225 + $2,228) can only be deducted in 2016 to the extent that Mr. Franklin has taxable capital gains in that year. If all or part of it cannot be currently used, the unused portion can be carried back 3 years and forward without limit, to be applied against taxable capital gains in those years.

Note that because Mr. Franklin is an individual, the ITA 39(1.1) deduction of $200 reduces the capital loss on the foreign exchange conversion.

TIF Solution Eight - 13

Case A

In this Case, the Federal Court Trials Division decided that the profit on the sale of the apartment building was a capital gain. They based their decision largely on the fact that it appeared that the **Intent** of the taxpayer was to operate the apartment building as an income producing property.

Case B

In this Case, the Minister Of National Revenue argued that because of the **Frequency Of Transactions**, the taxpayer was in the business of buying and selling cars and, as a consequence, profits on the sale of cars should be treated as business income. However, the taxpayer was successful in refuting the Minister's view by arguing that the **Nature Of The Transaction** was such that the assets should be viewed as capital assets and any resulting profits as capital gains.

Case C

The gains on the various sales of residential property were ruled to be business income. The primary consideration in this Case seemed to be the **Relation Of The Transactions To The Regular Business** of the taxpayer. The work that was done on the residential properties was so closely related to the normal business activities of the interior designer that they should be considered as part of the income from that business.

Case D

The Tax Appeals Board concluded that the amounts involved were business income rather than capital gains. The **Nature Of The Transaction** seemed to be the primary consideration in this Case. The Board indicated that the transaction was no more than an ingeniously contrived scheme to pay sums of money for another ten years in return for the right to fill the doctors' prescriptions. Therefore, the amounts constituted income from their profession.

Case E

Here again, the Tax Appeals Board concluded that the amounts involved were not capital gains. In this Case, primary emphasis was placed on the fact that the **Company's Charter** was not limited to dairy farming, but allowed them to undertake such real estate transactions.

Case F

The profits on trading in racehorses were ruled as business income. The primary point made was the **Relation Of The Transactions To The Regular Business** of the taxpayer. There was also mention of the **Frequency Of The Transactions**.

TIF Solution Eight - 14

2014 Results

During 2014, 80 percent of the property is used for income producing purposes. Based on this the maximum CCA that can be deducted for this year is calculated as follows:

Capital Cost [(80%)($500,000)]	$400,000
One-Half Net Additions	(200,000)
CCA Base	$200,000
Maximum CCA [(4%)($200,000)]	(8,000)
One-Half Net Additions	200,000
UCC - January 1, 2015	$392,000

There are no additional tax consequences during this year.

2015 Results - Business To Personal Use

On January 1, 2015, there would be a deemed disposition/acquisition of 20 percent of the total property. This would result in a taxable capital gain on the land calculated as follows:

Proceeds Of Disposition [(20%)($230,000)]	$46,000
Adjusted Cost Base [(20%)($225,000)]	(45,000)
Capital Gain	$ 1,000
Inclusion Rate	1/2
Taxable Capital Gain On Land	$ 500

There would also be taxable capital gain on the building, calculated as follows:

Proceeds Of Disposition [(20%)($585,000)	$117,000
Adjusted Cost Base [(20%)($500,000)]	(100,000)
Capital Gain	$ 17,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 8,500

The maximum CCA for 2015 would be calculated as follows:

Opening UCC	$392,000
Disposition: Lesser Of:	
Capital Cost [(20%)($500,000)] = $100,000	
Proceeds Of Disposition	
[(20%)($585,000) = $117,000	(100,000)
CCA Base	$292,000
Maximum CCA [(4%)($292,000)]	(11,680)
UCC - January 1, 2016	$280,320

2016 Results - Personal To Business Use

On January 1, 2016, there would be a deemed disposition/acquisition of 40 percent of the total property. This would result in a taxable capital gain on the land, calculated as follows:

Proceeds Of Disposition [(40%)($245,000)]		$98,000
Adjusted Cost Base:		
[(20%)($225,000)]	($45,000)	
[(20%)($230,000)]	(46,000)	(91,000)
Capital Gain		$ 7,000
Inclusion Rate		1/2
Taxable Capital Gain On Land		$ 3,500

There would also be a taxable capital gain on the building, calculated as follows:

Proceeds Of Disposition [(40%)($630,000)]		$252,000
Adjusted Cost Base:		
[(20%)($500,000)]	($100,000)	
[(20%)($585,000)]	(117,000)	(217,000)
Capital Gain		$ 35,000
Inclusion Rate		1/2
Taxable Capital Gain		$ 17,500

With respect to maximum CCA, this change in use involves a deemed disposition/acquisition from personal use to business use. In addition, the fair market value of the building is greater than her cost. Given this, the UCC will be limited to her cost plus one-half of the difference between fair market value and cost. This amount would be $17,500, as calculated in the preceding table as the taxable capital gain.

Maximum CCA for would be calculated as follows:

Opening UCC		$280,320
Deemed Acquisition Cost		
[(20%)($500,000)]	$100,000	
[(20%)($585,000)]	117,000	
Bump Up	17,500	234,500
One-Half Net Additions		(117,250)
CCA Base		$397,570
Maximum CCA [(4%)($397,570)]		(15,903)
Add: One-Half Net Additions		117,250
UCC - January 1, 2017		$498,917

Note To Instructors

We have asked students to ignore the principal residence exemption as the focus of the problem is on change in use. The textbook states that if there is non-residential use of a principal residence, the CRA will not apply the partial disposition rules so long as the income use is ancillary to the main use as a principal residence, there is no structural change to the property, and no CCA is claimed.

CCA was claimed on the 20 percent that went from business to principal residence back to business and the textbook does not specifically cover the effect of this CCA issue or a property where the principal residence portion is originally a small percentage of the total, on the principal residence exemption.

The fact that the business had claimed CCA on the 20 percent portion that was subsequently added to the personal portion when the business use dropped from 80 percent to 60 percent would not cause any adjustment to the principal residence. From a tax policy point of view, a change from personal use to business use is a concern since the personal use disposition results in capital gains with the added cost potentially being fully deductible as CCA. This is the reason why the change of use rules only allow half the increase in value to be added to cost. This issue does not arise, however when the property is converted from an income use to a personal use.

If the principal residence exemption was considered, when the 40 percent principal residence portion is changed to business use in 2016, that event would cause a disposition of a principal residence which would then be eligible for the principal residence exemption. As a result, there would be no net capital gain for 2016.

TIF Solution Eight - 15

Ms. Doan's taxable capital gain on deemed dispositions resulting from her departure from Canada would be calculated as follows:

ABC Ltd. Shares ($86,000 - $42,000)	$44,000
Vacant Land (Note 1)	N/A
Power Corporation Shares ($72,000 - $38,000)	34,000
TD Bank Shares ($72,000 - $84,000)	(12,000)
Sailboat (Note 2)	N/A
Oil Painting ($11,000 - $5,000)	6,000
Stamp Collection (Note 3)	(6,000)
Capital Gain	$66,000
Inclusion Rate	1/2
Taxable Capital Gain On Departure	$33,000

Note 1 Real property is exempted from the ITA 128.1(4)(b) deemed disposition requirement. However, as it is taxable Canadian property, a later sale of this land will attract Canadian income taxes, even though Ms. Doan is no longer a Canadian resident.

Note 2 Losses on personal use property are not deductible.

Note 3 Both the oil painting and the stamp collection are listed personal property. While there is a $9,000 ($12,000 - $3,000) loss on the stamp collection, it can only be deducted to the extent of the $6,000 gain on the oil painting. However, the remaining $3,000 ($9,000 - $6,000) can be carried back 3 years to be applied against any gains on listed personal property that occurred in those years. Although it can also be carried forward for up to 7 years, it is unlikely that Ms. Doan will have listed personal property in Canada once she becomes a non-resident.

TIF Solution Eight - 16

First Sale

Since Ms. Tosh has held the Tech Ltd. common shares for more than 185 days, it is a qualifying disposition. Since the Small Oil common shares were purchased immediately, they can be designated as replacement shares.

Preferred shares cannot be designated as replacement shares. As a result, the Small Bank Inc. shares do not qualify as replacement shares.

The capital gain on the Tech Ltd. disposition is $700,000 ($4,200,000 - $3,500,000). As the cost of replacement shares is only $3,800,000, the permitted deferral is limited as per the following calculation:

[($700,000)($3,800,000 ÷ $4,200,000)] = $633,333 Deferral

Given this, the adjusted cost base of the Small Oil shares would be calculated as follows:

Unadjusted Cost	$3,800,000
Deferral Amount	(633,333)
Adjusted Cost Base Of Small Oil Shares	$3,166,667

Second Sale

Since Ms. Tosh has held the Future Inc. common shares for more than 185 days, it is a qualifying disposition. Since the eligible small business corporation common shares were purchased in the current year, they can be designated as replacement shares.

The capital gain on the disposition of Future Inc. shares is $1,800,000 ($5,600,000 - $3,800,000). Of the $5,600,000 in proceeds, only $5,200,000 ($2,400,000 + $2,800,000) was invested in replacement shares. This means that the permitted deferral will be limited as per the following calculation:

[($1,800,000)($5,200,000 ÷ $5,600,000)] = $1,671,429 Deferral

Using this information, the adjusted cost base of the newly acquired shares would be calculated as follows:

	Sombra Shares	Ziff Shares
Purchase Price	$2,400,000	$2,800,000
Deferral:		
[($1,671,429)($2,400,000 ÷ $5,200,000)]	(771,429)	
[($1,671,429)($2,800,000 ÷ $5,200,000)]		(900,000)
Adjusted Cost Base	$1,628,571	$1,900,000

Net Taxable Capital Gain

If Ms. Tosh does not purchase any other replacements shares within 120 days of December 31, 2016, the two sales would result in a taxable capital gain, calculated as follows:

	Total Gain	Deferral	Net Gain
Tech Ltd. Shares	$ 700,000	$ 633,333	$ 66,667
Future Inc. Shares	1,800,000	1,671,429	128,571
Totals	$2,500,000	$2,304,762	$195,238
Inclusion Rate			1/2
Net Taxable Capital Gain			$ 97,619

Advice

If Ms. Tosh invests in any eligible small business corporation common shares, including her brother's company's, within 120 days of December 31, 2016, she can designate up to $800,000 as replacement shares. She would then be able to defer more or all of the capital gain on the two sales of shares.

If she wants to invest in her brother's company after the 120 days has passed, she should review her other investments to determine if she can use the deferral provisions on small business investments to her advantage to obtain the $1,000,000.

There is the question of whether Ms. Tosh should invest in her brother's new company, but that would involve an analysis that goes beyond the scope of the material in the text.

TIF Solution Eight - 17

Part A

The 2016 tax consequences would be as follows:

Land The Company would have a taxable capital gain on the Land calculated as follows:

Proceeds Of Disposition	$1,100,000
Adjusted Cost Base	(350,000)
Capital Gain	$ 750,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 375,000

Building The Company would have a taxable capital gain and recapture calculated as follows:

Proceeds Of Disposition	$2,300,000
Capital Cost	(2,100,000)
Capital Gain	$ 200,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 100,000

Opening UCC	$ 850,000
Deduct Disposition - Lesser Of:	
Capital Cost = $2,100,000	
Proceeds Of Disposition = $2,300,000	(2,100,000)
Negative Closing UCC Balance = Recapture	($1,250,000)
Recapture (Included In Income)	1,250,000
UCC - January 1, 2017	Nil

Equipment The Company would have recapture calculated as follows:

Opening UCC	$165,000
Deduct Disposition - Lesser Of:	
Capital Cost = $450,000	
Proceeds Of Disposition = $320,000	(320,000)
Negative Closing UCC Balance = Recapture	($155,000)
Recapture (Included In Income)	155,000
UCC - January 1, 2017	Nil

Part B

Land With respect to the Land, the capital gain resulting from the use of the ITA 44(1) election would be the lesser of:

- $750,000 (regular capital gain); and
- $500,000 (the excess of the $1,100,000 proceeds of disposition for the old land over the $600,000 cost of the replacement land).

The taxable amount would be $250,000 [(1/2)($500,000)] and this would be included in the revised 2016 Net Income For Tax Purposes. The original gain of $375,000 would be eliminated in the revised return.

If the ITA 44(1) election is used in 2017, the deemed adjusted cost base of the replacement land would be calculated as follows:

Actual Cost	$600,000
Capital Gain Reversed By Election ($750,000 - $500,000)	(250,000)
Deemed Adjusted Cost Base Of Replacement Land	$350,000

Note that the deemed adjusted cost base of the replacement land has been reduced to the adjusted cost base of the old land.

Building If the ITA 44(1) election is used in 2017, the amended 2016 capital gain would be nil, the lesser of:

- $200,000 (regular capital gain); and
- Nil (reflecting the fact that there was no excess of the $2,300,000 proceeds of disposition for the old building over the $2,500,000 cost of the replacement building).

Using this election will reduce the deemed capital cost for the building as follows:

Actual Cost	$2,500,000
Capital Gain Reversed By Election	(200,000)
Deemed Capital Cost Of Replacement Building	$2,300,000

If the ITA 13(4) election is used in 2017, the amended 2016 recapture would be calculated as follows:

January 1, 2016 UCC Balance		$850,000
Deduction:		
Lesser Of:		
• Proceeds Of Disposition = $2,300,000		
• Capital Cost = $2,100,000	($2,100,000)	
Reduced By The Lesser Of:		
• Normal Recapture = $1,250,000		
• Replacement Cost = $2,500,000	1,250,000	(850,000)
Recapture Of 2016 CCA (Amended)		Nil

If both elections are used in 2017, the UCC of the replacement building is calculated as follows:

Deemed Capital Cost	$2,300,000
Recapture Reversed By Election	(1,250,000)
UCC - Replacement Building	$1,050,000

Note that the $1,050,000 UCC for the new building is equal to the UCC of the old building ($850,000), plus the additional $200,000 ($2,500,000 - $2,300,000) in funds required for its acquisition.

These new nil figures for the capital gain and the recapture on the disposition of the old building will replace the old figures of $100,000 and $1,250,000 that were included in the original 2016 return.

Equipment As this is a voluntary disposition, the ITA 13(4) and 44(1) elections can only be used on real property (land and buildings). They cannot be used on the equipment and, as a consequence, the $155,000 in recapture will not be altered in the amended return. As the elections cannot be used, both the capital cost and the UCC of the new equipment will be $520,000.

Part C

The Election The ITA 44(6) election applies when there is a disposition involving a combination of part land and part building. If, for either of the assets, the proceeds of disposition exceed the adjusted cost base, the election allows the transfer of all or part of that excess to the other asset.

As will be demonstrated in this problem, this can provide some relief when ITA 44(1) and ITA 13(4) fail to eliminate all of the capital gains arising on one part of the disposition of the old property. ITA 44(1) fully eliminated the capital gain on the building. However, a $500,000 capital gain remained on the land. This would suggest that it could be advantageous to transfer some of the proceeds of disposition from the land to the building.

The excess of the proceeds of disposition of the old land over the cost of the replacement land was $500,000 ($1,100,000 - $600,000). This is the maximum available transfer from the land to the building. However, the excess of the cost of the replacement building over the old building's proceeds of disposition is only $200,000 ($2,500,000 - $2,300,000). If a transfer in excess of this amount is made, any reduction in the capital gain on the land will be matched by an increased capital gain on the building.

Applying ITA 44(6) in an optimal manner will result in the following adjusted proceeds of disposition:

	Land	Building
Actual Proceeds Of Disposition	$1,100,000	$2,300,000
Optimal Transfer Land To Building	(200,000)	200,000
Adjusted Proceeds Of Disposition	$ 900,000	$2,500,000

Application To Land If both ITA 44(1) and ITA 44(6) are applied, the resulting capital gain on the land will be calculated as the lesser of:

- $550,000 ($900,000 - $350,000); and
- $300,000 (the excess of the $900,000 adjusted proceeds of disposition for the old land over the $600,000 cost of the replacement land).

This is a reduction of $200,000 ($500,000 - $300,000) from the amount that was calculated when only ITA 44(1) was applied. However, the adjusted cost base of the land would be unchanged by the use of ITA 44(6):

Actual Cost	$600,000
Capital Gain Reversed By Election ($550,000 - $300,000)	(250,000)
Deemed Adjusted Cost Base Of Replacement Land	$350,000

Application To Building With the proceeds of disposition transfer limited to $200,000, the capital gain on the building is still nil. Specifically, the gain will be the lesser of:

- $400,000 ($2,500,000 - $2,100,000); and
- Nil (reflecting the fact that there was no excess of the $2,500,000 adjusted proceeds of disposition for the old building over the $2,500,000 cost of the replacement building).

However, the capital cost and UCC of the building will be reduced by the application of ITA 44(6):

Actual Cost	$2,500,000
Capital Gain Reversed By The Two Elections	(400,000)
Deemed Capital Cost	$2,100,000
Recapture Reversed By Election	(1,250,000)
UCC - Replacement Building	$ 850,000

Note that the UCC for the new building is equal to the UCC of the old building.

Comparison The table which follows compares the results of using only ITA 44(1) and ITA 13(4) with the results that arise when the ITA 44(6) election is also used.

	No ITA 44(6)	With ITA 44(6)
Capital Gains		
Land	$500,000	$300,000
Building	Nil	Nil
Replacement Property		
Adjusted Cost Base Of Land	$ 350,000	$ 350,000
Capital Cost Of Building	2,300,000	2,100,000
UCC	1,050,000	850,000

As you can see in the table, the use of ITA 44(6) has reduced the capital gain on the land by $200,000. However, it has done so at the cost of reducing the capital cost and UCC of the replacement building. There is a tax cost associated with this trade off in that only one-half of the capital gain would have been taxed in the current year, whereas the future CCA that has been lost would be fully deductible.

TIF Solution Eight - 18

Part A

The 2016 tax consequences of the involuntary disposition would include both taxable capital gains and recapture. The amounts would be calculated as follows:

	Land	Building
Proceeds Of Disposition:		
Sale Price Of Land	$200,000	
Insurance Proceeds For Building		$1,000,000
Adjusted Cost Base/Capital Cost	(150,000)	(750,000)
Capital Gain	$ 50,000	$ 250,000
Inclusion Rate	1/2	1/2
Taxable Capital Gain	$ 25,000	$ 125,000

January 1, 2016 UCC Balance	$ 425,000
Lesser Of:	
• Cost = $750,000	
• Proceeds Of Disposition = $1,000,000	(750,000)
December 31 UCC Balance	($ 325,000)
Recapture	325,000
January 1, 2017 UCC	Nil

For 2016, there is no CCA claim. Instead, there is $325,000 in recaptured CCA that must be taken into income.

As a result of this involuntary disposition, Winding will have an addition to their 2016 Net Income For Tax Purposes of $475,000 ($25,000 + $125,000 + $325,000).

Part B

After the land and building are replaced in 2017, an election can be made under ITA 44(1), and an amended return can be filed for 2016. In the amended return, the capital gains will be nil, the lesser of the amounts calculated in Part A and the following:

	Land	Building
Proceeds Of Disposition	$200,000	$1,000,000
Less: Cost Of Replacement Property	(300,000)	(1,100,000)
Excess, If Any	Nil	Nil

The reversed amounts will have to be removed from the capital costs of the new assets, resulting in the following revised capital cost values:

	New Land	New Building
Capital Cost	$300,000	$1,100,000
Capital Gain Reversed By Election	(50,000)	(250,000)
Deemed Capital Cost	$250,000	$ 850,000

These values can also be calculated by taking the old capital costs of $150,000 and $750,000, and adding the additional funds required to replace the old assets ($100,000 for the land and $100,000 for the building).

An election can also be made under ITA 13(4) to amend the 2016 recapture. The calculation would be as follows:

January 1, 2016 UCC Balance		$425,000
Deduction:		
Lesser Of:		
• Proceeds Of Disposition = $1,000,000		
• Capital Cost = $750,000	$750,000	
Reduced By The Lesser Of:		
• Normal Recapture = $325,000		
• Replacement Cost = $1,100,000	(325,000)	(425,000)
Recapture Of 2016 CCA (Amended)		Nil

The UCC of the new building will be adjusted for this change as follows:

Deemed Capital Cost Of Building (See Preceding Calculation)	$ 850,000
Recapture Reversed - ITA 13(4) Election	(325,000)
UCC	$ 525,000

This $525,000 can also be calculated as the old UCC of $425,000, plus the $100,000 ($1,100,000 - $1,000,000) in funds invested by Winding in excess of the insurance proceeds.

Part C

The CCA claim for 2017 would be calculated as follows:

Opening UCC Balance	Nil
Addition of New Building UCC	$525,000
One-Half Net Additions	(262,500)
CCA Base	$262,500
Rate For Class 1	4%
CCA For 2017	$ 10,500

TIF Solution Eight - 19

Part A

Whether or not the expropriated assets are replaced, the Company will experience capital gains and recapture in 2016 as follows:

	Land	Building
Compensation Received	$130,000	$430,000
Adjusted Cost Base - Capital Cost	(88,000)	(290,000)
Capital Gains	$ 42,000	$140,000
Inclusion Rate	1/2	1/2
Taxable Capital Gains	$ 21,000	$ 70,000

Opening UCC	$248,000
Deduct Disposition - Lesser Of:	
• Capital Cost = $290,000	
• Proceeds Of Disposition = $430,000	(290,000)
Negative Closing UCC Balance = Recapture	($ 42,000)

Part B

As the assets were replaced before the end of the second taxation year following the receipt of the expropriation proceeds, Janchek can use both ITA 44(1) and ITA 13(4) to modify these results. These changes will be implemented through an amended return.

Under ITA 44(1) the revised capital gain on the land would be nil, the lesser of:

- $42,000 as calculated in the preceding table; and
- Nil (there was no excess of the $130,000 proceeds of disposition for the old land over the $210,000 cost of its replacement).

Again under ITA 44(1), the revised capital gain on the building would be nil, the lesser of:

- $140,000 as calculated in the preceding table; and
- Nil (there was no excess of the $430,000 proceeds of disposition for the old building over the $840,000 cost of its replacement).

Under ITA 13(4), the revised recapture would be calculated as follows:

January 1, 2016 UCC Balance		$248,000
Deduction:		
Lesser Of:		
• Proceeds Of Disposition = $430,000		
• Capital Cost = $290,000	$290,000	
Reduced By The Lesser Of:		
• Normal Recapture = $42,000		
• Replacement Cost = $840,000	(42,000)	(248,000)
Recapture Of 2016 CCA (Amended)		Nil

Part C

Since Janchek decides to eliminate the capital gains and recapture by using the elections under ITA 44(1) and ITA 13(4), the deemed cost and UCC of the replacement properties would be as follows:

	Land	Building
Actual Cost Of Replacement Property	$210,000	$840,000
Capital Gain Reversed By Election	(42,000)	(140,000)
Deemed Cost Of Replacement Property	$168,000	$700,000
Deemed Capital Cost Of Building		$700,000
Recaptured CCA Reversed By Election		(42,000)
UCC		$658,000

With respect to the economic basis for these amounts, the $168,000 value for the land is equal to the adjusted cost base of the old land ($88,000), plus the additional $80,000 ($210,000 - $130,000) in funds paid by Janchek in excess of the expropriation proceeds.

The deemed cost of the replacement building is equal to the adjusted cost base of the expropriated building ($290,000), plus the additional $410,000 ($840,000 - $430,000) in funds invested by Janchek in excess of the expropriation proceeds.

The UCC for the new building is equal to the UCC of the old building ($248,000), plus the additional $410,000 ($840,000 - $430,000) in funds invested by Janchek in excess of the expropriation proceeds.

TIF Solution Eight - 20

1. The described treatment is not correct. While Mr. Acker has not sold any property, a part of his building has undergone a change in use from a rental property to a personal use property. As a consequence, there will be a deemed disposition at fair market value for that portion of the building that he is occupying. Any resulting capital gain or loss will have to be reflected in his current tax return. If he had not taken CCA on the property, he could have filed an election to postpone the recognition of the capital gain until he sells the property.

2. This interpretation is not correct. No recognition can be given to the estimated cost of the warranty prior to the provision of the warranty services. As a consequence, a capital gain of $33,000 will have to be recognized. However, when the warranty services are provided, the costs of providing the services can be treated as capital losses.

3. The described treatment is correct. Losses on the sale of personal use property such as the table are not deductible. The gain on the painting is not taxable as both the adjusted cost base and the proceeds are less than $1,000.

4. The described treatment is the appropriate one.

Proceeds Of Disposition ($11,600 - $200)	$11,400
Adjusted Cost Base ($11,200 - $800)	(10,400)
Capital Gain	$ 1,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 500

5. The described treatment is the appropriate one.

TIF Solution Eight - 21

Net Business Income

Mr. Bosch's Net Business Income would be calculated as follows:

Accounting Income Before Taxes	$196,000
Additions:	
Accounting Amortization	29,000
Charitable Donations	5,500
Political Contributions	700
Meals And Entertainment [(1/2)($27,600)]	13,800
Deductions:	
CCA (Note 1)	(39,475)
Landscaping Costs (Note 2)	(30,000)
Warranty Costs (Note 3)	(4,500)
Net Business Income	$171,025

Note 1 The relevant CCA calculations are as follows:

Opening UCC - Class 8	$ 83,000
Additions	63,250
Dispositions - Lesser Of:	
Cost = $46,000	
Proceeds Of Disposition = $28,500	(28,500)
One-Half Net Additions [(1/2)($63,250 - $28,500)]	(17,375)
CCA Base	$100,375
Rate	20%
Class 8 CCA	$ 20,075
Class 1 CCA [(4%)($275,000)]	11,000
Class 10 CCA [(30%)($28,000)]	8,400
Total	$ 39,475

Note 2 Landscaping costs can be deducted under ITA 20(1)(aa) when paid. As $3,000 ($30,000 ÷ 10) was charged to accounting income as amortization, but was added back in the calculation of net business income, the adjustment is for the total amount of $30,000.

Note 3 Since the liability for warranty costs decreased during the year, the actual expenditures for warranty costs must have been greater than the amount expensed for accounting purposes. As a result, there is a deduction from net business income for the $4,500 ($22,000 - $17,500) difference between the opening and ending liability. Stated alternatively, the opening balance of $22,000 can be deducted for tax purposes, while the closing balance of $17,500 cannot be deducted. To adjust accounting income, we require a net deduction of $4,500.

Property Income

Mr. Bosch's only property income is from the rental of the cottage. The required calculations are as follows:

Rent Revenues	$12,000
Rent Expenses Other Than CCA	(3,200)
CCA (See Following Calculation)	(2,950)
Net Rental Income	$ 5,850

Cost Of Building ($25,000 - $5,000)	$ 20,000
Bump Up [(1/2)($375,000 - $100,000 - $20,000)]	127,500
Cost For UCC And CCA Purposes	$147,500
One-Half Net Additions [(1/2)($147,500)]	(73,750)
CCA Base	$ 73,750
Rate For Class 1	4%
CCA	$ 2,950

Net Taxable Capital Gains

Mr. Bosch's Net Taxable Capital Gains are as follows:

Gain On Vacant Land (Note 4)	$ 21,412
Gain On Rental Property (Note 5)	194,444
Loss On Shares (Note 6)	(20,686)
Net Capital Gains	$195,170
Inclusion Rate	1/2
Net Taxable Capital Gains	$ 97,585

Note 4 The capital gain on the vacant land would be calculated as follows:

Proceeds Of Disposition	$85,000
Adjusted Cost Base	(33,000)
Capital Gain	$52,000
Reserve - Lesser Of:	
[($52,000)($50,000 ÷ $85,000)] = $30,588	
[($52,000)(20%)(4 - 0)] = $41,600	(30,588)
Capital Gain	$21,412

Note 5 The capital gain on the change in use is as calculated as follows:

	Land	Building
Deemed Proceeds Of Disposition	$100,000	$275,000
Adjusted Cost Base	(5,000)	(20,000)
Capital Gain	$ 95,000	$255,000

This gives a total gain on the deemed disposition of $350,000 ($95,000 + $255,000). Mr. Bosch can designate the property as his principal residence for the years 2008 through 2010. Given this and the fact that he has owned the cottage for 9 years (2008 through 2016), his exemption is equal to $155,556 {[($350,000)(3 + 1)] ÷ 9}. Also note that, because he intends to deduct CCA, he cannot make the ITA 45(2) election not to have a change in use. This leaves a capital gain of $194,444 ($350,000 - $155,556).

Note 6 The capital loss on Low Tech Ltd. shares would be calculated as follows:

Proceeds Of Disposition [(275)($5)]	$ 1,375
Adjusted Cost Base (See Following Calculation)	(22,061)
Capital Loss	($20,686)

The average cost of the shares held would be $80.22 per share {[(150)($55) + (125)($75) + (300)($95)] ÷ 575}. Based on this value, the adjusted cost base of the shares sold would be $22,061 [(275)($80.22)].

Net Income For Tax Purposes

Mr. Bosch's Net Income For Tax Purposes would be calculated as follows:

Net Business Income	$171,025
Net Property Income	5,850
Net Taxable Capital Gains	97,585
Subdivision e Deduction - CPP Payments (Note 7)	(2,544)
Net Income For Tax Purposes	$271,916

Note 7 One-half of the CPP payments, or $2,544 [(1/2)($5,088)] is deductible under Subdivision e. Although Subdivision e deductions are not specifically covered until Chapter 9, Chapter 4 specifies that a self-employed individual will have a tax credit equal to one-half of his CPP contributions for self-employed income, and a deduction for the remaining one-half.

Taxable Income

As there are no Taxable Income deductions available, Mr. Bosch's Taxable Income is equal to his Net Income For Tax Purposes.

Balance Owing

The required calculations here would be as follows:

Tax On First $200,000		$46,317
Tax On Next $71,916 ($271,916 - $200,000) At 33 Percent		23,732
Tax Before Credits		$70,049
Tax Credits:		
Basic Personal Amount	($11,474)	
Common-Law Partner ($11,474 - $720)	(10,754)	
Family Caregiver - Chris	(2,121)	
CPP [(1/2)($5,088)]	(2,544)	
Transfer Of Chris' Disability	(8,001)	
Chris' Disability Supplement	(4,667)	
Medical Expenses (Note 8)	(19,008)	
Total Credit Base	($58,569)	
Rate	15%	(8,785)
Subtotal		$61,264
Charitable Donations Credit (Note 9)		(1,779)
Political Donations [(3/4)($400) + (1/2)($300)]		(450)
CPP Payable		5,088
Balance Owing (Federal)		$64,123

Note 8 The base for the medical expense tax credit would be as follows:

Total Medical Expenses	$21,245
Lesser Of:	
• [(3%)($271,916)] = $8,157	
• 2016 Threshold Amount = $2,237	(2,237)
Medical Expense Tax Credit Base	$19,008

Note 9 Arnold's charitable donations tax credit would be calculated as follows:

15 Percent Of $200	$ 30
33 Percent Of The Lesser Of:	
$5,300 ($5,500 - $200)	
$71,916 ($271,916 - $200,000)	1,749
29 Percent Of Nil ($5,300 - $5,300)	Nil
Total Credit	$1,779

TIF Solution Eight - 22

Employment Income

Paul's commission income of $62,500 is large enough not to limit the deduction of his employment related expenses. The required calculations would be as follows:

Salary	$ 85,000
Additions:	
Commissions	62,500
Stock Option Benefit [(1,500)($19 - $15)]	6,000
Expense Allowance [(12)($2,500)]	30,000
Deductions:	
RPP Contributions	(4,100)
Professional Association Dues	(1,500)
Work Space In The Home Expenses (Note 1)	(2,290)
Automobile Costs	
CCA (Note 2)	(6,120)
Operating Costs [(80%)($6,100)]	(4,880)
Hotel Costs	(11,500)
Airline And Other Transportation	(9,200)
Client Meals And Entertainment [(1/2)($10,400)]	(5,200)
Net Employment Income	$138,710

Note 1 As Paul has commission income, he can deduct 20 percent of all of the costs except the mortgage interest. This will provide a deduction of $2,290 [(20%)($3,400 + $7,200 + $850)].

Note 2 The 2016 CCA would be based on a UCC calculated as though 100 percent of the available CCA had been taken in 2015. The 100 percent CCA for 2015 would be $4,500 [(1/2)(30%)($30,000)]. Using this figure, the deductible 2016 CCA would be $6,120 [(80%)(30%)($30,000 - $4,500)]. Note that the original base for CCA is limited to the Class 10.1 maximum of $30,000.

Property Income

The required calculations here would be as follows:

Non-Eligible Dividends	$ 5,400
Gross Up On Non-Eligible Dividends [(17%)($5,400)]	918
Net Rental Income (Note 3)	18,500
Net Property Income	$24,818

Note 3 As the change in use is from personal to business, the base for calculating CCA would be as follows:

Cost Of Building ($250,000 - $75,000)		$175,000
Fair Market Value At Change In Use ($375,000 - $100,000)	$275,000	
Cost	(175,000)	
Increase In Value (Bump Up)	$100,000	
Inclusion Factor	1/2	50,000
Cost For UCC And CCA Purposes		$225,000
One-Half Net Additions		(112,500)
CCA Base		$112,500
Rate For Class 1		4%
CCA		$ 4,500

Using this CCA figure, net rental income would be $18,500 ($23,000 - $4,500).

Net Taxable Capital Gains

The required calculations here would be as follows:

Stock Option Shares [(1,500)($22 - $19)]		$ 4,500
Sale Of Paintings (Note 4)		Nil
Land Sale		
Total Gain ($350,000 - $100,000)	$250,000	
Reserve For Land Sale (Note 5)	(178,571)	71,429
Change In Use:		
Cottage - Land ($100,000 - $75,000)	$ 25,000	
Cottage - Building ($275,000 - $175,000)	100,000	125,000
Net Capital Gains		$200,929
Inclusion Rate		1/2
Net Taxable Capital Gains		$100,465

Note 4 The paintings would be listed personal property, which means that losses are only deductible to the extent of gains on listed personal property. While there was a gain on one painting of $5,000 ($15,000 - $10,000), there was a loss on the second painting of $6,000 ($10,000 - $4,000). This loss can be used to eliminate the gain on the first painting. However, the remaining $1,000 ($6,000 - $5,000) cannot be deducted in the current year. It can be carried back 3 years and forward 7 years to be applied against listed personal property gains in those years.

Note 5 The total proceeds of disposition for the land would be $350,000 [$100,000 + (5)($50,000)]. Given this, the gain on the land would be $250,000 ($350,000 - $100,000). The maximum reserve would be $178,571, the lesser of:

- $178,571 [($250,000)($250,000 ÷ $350,000)]
- $200,000 [($250,000)(20%)(4 - 0)]

Net And Taxable Income

The required calculations here would be as follows:

Net Employment Income	$138,710
Net Property Income	24,818
Net Taxable Capital Gains	100,465
Net Income For Tax Purposes	**$263,993**
Stock Option Deduction [(1/2)($6,000)]	(3,000)
Taxable Income	**$260,993**

Federal Tax Payable

The required calculations here would be as follows:

Tax On First $200,000		$46,317
Tax On Next $60,993 ($260,993 - $200,000) At 33 Percent		20,128
Tax Before Credits		$66,445
Tax Credits:		
Basic Personal Amount	($11,474)	
Spouse ($11,474 - $8,400)	(3,074)	
Family Caregiver For May	(2,121)	
Transfer Of May's Disability	(8,001)	
Disability Supplement	(4,667)	
Transfer Of Education Credits (Note 6)	(5,000)	
Transit Passes [(2)(12)($200) + (12)($100)]	(6,000)	
Childrens' Arts Program (Maximum)	(250)	
Medical Expenses (Note 7)	(14,563)	
EI	(955)	
CPP	(2,544)	
Canada Employment	(1,161)	
Total Credit Base	($59,810)	
Rate	15%	(8,972)
Subtotal		$57,473
Charitable Donations Credit (Note 8)		(360)
Non-Eligible Dividend Tax Credit [(21/29)($918)]		(665)
Federal Tax Payable		$56,448

Note 6 The transfer of Virginia's tuition, education and textbook credits would be $5,000, the lesser of:

- $5,000
- [$9,350 + (9)($400) + (9)($65)] = $13,535

Note 7 The base for the medical expense tax credit would be calculated as follows:

Total Medical Expenses	$16,800
Lesser Of:	
• [(3%)($263,993)] = $7,920	
• 2016 Threshold Amount = $2,237	(2,237)
Medical Expense Tax Credit Base	$14,563

Note 8 The charitable donations tax credit would be calculated as follows:

15 Percent Of $200	$ 30
33 Percent Of The Lesser Of:	
$1,000 ($1,200 - $200)	
$63,993 ($263,993 - $200,000)	330
29 Percent Of Nil ($1,200 - $1,200)	Nil
Total Credit	$360

Chapter Nine Test Item File Solutions

TIF Solution Nine - 1

1. A retiring allowance is an amount received, either on, or after retirement in recognition of long service or, alternatively, an amount received in respect of a loss of employment. The full amount of such allowances must be included in income in the year that it is received. While this is not part of the answer to the question as stated, you might note that, within specified limits, all or part of the allowance may be transferred to an RRSP and deducted in the calculation of Net Income For Tax Purposes.

2. A death benefit is the total of all amounts received by a taxpayer in a taxation year on or after the death of an employee in recognition of the employee's service in an office or employment. The definition of this benefit is stated in such a way that it does not include the first $10,000 of such payments. This means that they can, in effect, be received tax free.

3. In general, there is 100 percent exemption of scholarships and prizes that are received in connection with:

   - an education program that qualifies for the education tax credit; and
   - an elementary or secondary school education program.

   However, there are a number of exceptions to this exemption:

   - At the post-secondary level, the exemption will only be available to the extent it relates to a college or CEGEP diploma, or a bachelor, masters or doctoral degree. This means it will not be available for most post-doctoral fellowships.
   - Again, at the post-secondary level, the exemption will only be available in situations where it is reasonable to conclude that the scholarship was received to support the taxpayer's enrolment in a post-secondary program.
   - With respect to scholarships received in connection with part-time enrollment, except in cases where the need to enroll on a part time basis is related to a physical or mental impairment, the exemption will be limited to the amount of tuition paid, plus costs of program-related materials.

4. They are included in Net Income For Tax Purposes because that figure is used in a variety of eligibility tests. For example, to get the full tax credit for an infirm dependant over 17, the dependant's income must be less than a threshold amount. Since the policy is to reduce this credit in proportion to the dependant's income in excess of that amount, it is important that all types of income be included in the Net Income For Tax Purposes calculation. To accomplish this goal, social assistance and workers' compensation payments are included in the calculation of Net Income For Tax Purposes and then deducted in the calculation of Taxable Income.

5. Single parents have the following options with respect to the inclusion of the universal child tax benefit in income:

   - They can include it in their own income.
   - Single individuals can include it in the income of a dependant who qualifies for the eligible dependant tax credit.
   - If the eligible dependant tax credit is not claimed, single individuals can include it in the income of the child for whom the benefit is received.

6. Deductibility of moving expenses is available to three categories of taxpayers. They are as follows:

- Taxpayers who move to a new work location (a new work location may not involve a new employer), either as:
  - employees,
  - independent contractors, or
  - after ceasing to be a full time student at a post-secondary institution.
- Taxpayers who move in order to commence full time attendance at a post-secondary institution and receive income from the educational institution that increases their Net Income For Tax Purposes.
- An unemployed taxpayer who moves to a new location in Canada to take up employment at that new location.

7. An employer can compensate an employee for a loss on the sale of a home that was sold because of a required move. However, the tax free amount of compensation is limited to the first $15,000, plus one-half of any compensation in excess of $15,000. This means that one-half of any amount of compensation in excess of $15,000 will be treated as a taxable benefit to the employee.

8. An eligible child is defined in ITA 63(3) to include a child of the taxpayer, his spouse or common-law partner, or a child who is dependent on the taxpayer or his spouse or common-law partner and whose income does not exceed the basic personal credit amount . In addition, the child must be under 16 years of age at some time during the year or dependent on the taxpayer or his spouse by reason of physical or mental infirmity.

9. The objective of providing the disability supports deduction is to assist individuals with the extra costs that a disabled person incurs when trying to attend school or work. Examples of such costs that are cited in the text are as follows:

   - sign-language interpretation services, a teletypewriter or similar device;
   - a Braille printer;
   - an optical scanner, an electronic speech synthesizer;
   - note-taking services, voice recognition software, tutoring services; and
   - talking textbooks.

10. When there is a significant disparity in the incomes of a couple, pension income splitting is usually desirable. However, if the disparity is not very significant, pension income splitting may not be attractive. Factors that have to be considered include loss of the transferee's age credit or a decrease in the medical expenses credit. The OAS clawback may also be involved in the analysis. Making a decision in this area requires a case-by-case analysis.

11. The specific conditions that must be met are set out in IT Folio S1-F3-C3 as follows:

    - the amount is paid as alimony or an allowance for the maintenance of the spouse or common-law partner, or former spouse or common-law partner;
    - the spouses or common-law partners, or former spouses or common-law partners, are living apart at the time the payment is made and throughout the remainder of the year, and were separated pursuant to a divorce, judicial separation, or written separation agreement;
    - the amount is paid pursuant to a decree, order, or judgment of a competent tribunal or pursuant to a written agreement;
    - the recipient has discretionary use of the amount; and
    - the amount is payable on a periodic basis.

12. The answer here depends on how the annuity was acquired. If it was purchased with tax deferred funds (e.g., funds from an RRSP), the full amount of the annuity payment will be included in Net Income For Tax Purposes and there will be no offsetting deduction.

    Alternatively, if the annuity was purchased with after tax funds (e.g., funds from a bank account), the full amount of the payment will still be included in income. However, there will be an offsetting deduction to reflect the fact that part of the payment is a return of capital. The amount of the deduction will be based on the cost of the annuity, divided by total payments to be received under the annuity, with this fraction multiplied by the individual annuity payment.

13. The major advantages would include:

    - The fact that making contributions results in additional contributions being made by the government in the form of Canada Education Savings Grants.
    - The fact that earnings on the invested contributions are not taxed as they accrue, providing for tax free compounding while the funds are in the plan.
    - The fact that these plans allow parents to allocate income to their children without triggering the income attribution rules.
    - The probability that the funds will be received by an eligible student either with no taxes being assessed or, at worst, with taxes being assessed at the lowest federal rate.

    Note that, while having an RESP can result in eligibility for Canada Learning Bonds contributions, this is not part of the answer to this question because these contributions are not dependent on others making a contribution to the RESP.

14. In the Canada Learning Bonds program, the government will make contributions to an RESP for a child whose family qualifies for the National Child Benefit supplement. The contributions will be made in each year that the child's family qualifies for the supplement, beginning with the year that the child is born and ending in the year that the child reaches age 15. The first payment will be for $500, plus an additional $25 to help defray the costs of establishing an RESP for the child. Subsequent payments will be for $100 in each year that the family qualifies. Unlike Canada Education Savings Grants, there is no requirement for contributions to be made in order for the RESP to receive the Canada Learning Bonds contributions.

15. There are several major advantages to the use of TFSAs:

    - Earnings in the plan accumulate on a tax free basis.
    - Withdrawals from the plan are not subject to tax.
    - Amounts earned in the plan are not subject to the income attribution rules.
    - Reductions in contribution room related to withdrawals are replaced in the following taxation year.

16. If an individual's spouse or common-law partner is designated as a successor holder, their TFSA can be transferred into the hands of this beneficiary as an ongoing TFSA. It can either be maintained by the individual as a separate TFSA or, alternatively, rolled over into their TFSA without being treated as a contribution. Income on the assets contained in the bequeathed TFSA will continue to accumulate on a tax free basis.

    If the decedent's TFSA is transferred to any other beneficiary, that individual can use the funds in the plan at the time of the transferor's death without tax consequences. However, any amounts received in excess of the fair market value of the assets in the plan at the time of the transferor's death will be subject to tax.

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

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

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

20. From the point of view of the transferor, the excess of the fair market value of the asset over its capital cost will be classified as a capital gain, only one-half of which is taxable. If the transferee was allowed to treat the full fair market value as its capital cost, this excess would become fully deductible CCA. To prevent this from happening, the transferee is only allowed to include one-half of the excess in his capital cost, resulting in its deduction being equal to the transferor's taxable gain.

21. There is a deemed disposition of all of an individual's capital property at death. The results of these dispositions can be described as follows:

    Capital Property Other Than Depreciable Property The deceased taxpayer is deemed to have disposed of the property at fair market value immediately before his death. The person receiving the property is deemed to have acquired the property at this time, at a value equal to its fair market value.

    Depreciable Property The basic rules for this type of property are the same. That is, there is a deemed disposition of the property by the deceased taxpayer at fair market value, combined with an acquisition of the property at the same value by the beneficiary. When the capital cost of the property for the deceased taxpayer exceeds its fair market value, the beneficiary is required to retain the original capital cost, with the difference being treated as deemed CCA.

22. The two basic rollovers that are available when an individual dies can be described as follows:

    Rollover To Spouse, Common-Law Partner, Or Spousal Trust This rollover allows the deceased's capital property to be transferred at tax values (UCC or adjusted cost base). It applies automatically unless the representatives of the deceased elect out of its provisions.

    Rollover Of Farm Or Fishing Property This rollover allows a farming or fishing property owned by the deceased to be transferred to a child or grandchild at tax values. This election applies automatically unless the representatives of the deceased elect out of its provisions.

23. When there is a transfer of a capital property to a spouse or common-law partner, income attribution will be applicable in the following circumstances:

    1. The income from the transferred property is property income. Income attribution is not applicable to business income.

    2. The transferor does not elect out of ITA 73(1). This would result in income attribution without regard to the consideration given for the property by the transferee.

    3. If the transferor elects out of ITA 73(1), income attribution will still apply unless the transferee provides consideration for the property that is equal to the fair market value of the property received.

24. If he gives the shares to his spouse and does not elect out of ITA 73(1), the shares will be transferred at their tax costs and there will be no tax consequences at the time of transfer. However, both dividends and any capital gain or loss resulting from a subsequent sale by the spouse will be attributed back to him.

    Alternatively, if the shares are gifted to the daughter, the transfer will take place at fair market value, resulting in a capital gain or loss at that time. Until the daughter reaches 18 years of age, any dividends paid on the shares will be attributed back to her father. However, if the daughter sells the shares, any resulting gain or loss (based on the fair market value at the time of transfer) will be taxed in the hands of the daughter.

25. There are a number of items listed in the text that could be mentioned here:

    - Contributing to an RESP for his child.
    - Contributing to a spousal RRSP.
    - Contributing to a TFSA for his spouse.
    - Contributing to a TFSA for his child once the child is 18 years of age.
    - Since business income is being earned in the family unit, pay reasonable salaries to family members for activities that can be justified as business related.
    - If pension income is received, make use of the pension splitting provisions.
    - Giving assets with anticipated capital gains to the child rather than the spouse.
    - Loans at the prescribed rate if safe investments with higher returns are available.
    - Segregating funds from sources to which the income attribution rules do not apply (i.e. gifts and inheritances).
    - Keeping records which detail that the lower income family members' funds are being used for investment purposes, rather than for non-deductible expenditures such as household expenses.
    - Allowing family members to invest at the inception of any new business.

    Other factors might also be mentioned.

TIF Solution Nine - 2

1. False. She must include only $15,000 ($25,000 - $10,000) in income in the year of receipt.

2. True. While the entire amount must be included, a deduction is available for eligible amounts that are transferred to an RRSP.

3(i). True. His airfare from Prince George to Red Deer is a deductible moving cost.

3(ii). True. The $750 is a deductible moving cost.

3(iii). True. The total $1,800 in legal fees is a deductible moving cost.

3(iv). False. The $2,000 is not a deductible moving cost.

3(v). True. The $5,000 in real estate fees paid to sell their Prince George house is a deductible moving cost.

3(vi). False. There is an unlimited carry forward for unused moving costs.

4. False. Sarah can deduct a maximum of $5,333 [(2/3)($8,000)].

5. False. An eligible child does not have to be under 16 at some time during the year if he or she is dependent on the taxpayer or his spouse or common-law partner by reason of physical or mental infirmity.

6. True. Imprisonment of the lower income spouse is one of the situations in which the higher income spouse is allowed to deduct child care costs.

7. True. The payments will be taxed in Jim's hands and will be deductible from Shirley's income. As there are no children, the amounts paid are spousal support.

8. True. If after tax funds are used, the capital element of the annuity payment can be deducted from the amount received. Alternatively, if RRSP funds are used, the entire annuity payment will be subject to tax, with no offsetting deduction for a capital element.

9. True.

10. True. While contributions are not deductible, earnings resulting from the investment of these contributions are not subject to tax until the funds are withdrawn from the plan.

11. False. There is no annual limit. Contributions are limited by contribution room.

12. False. There is no tax on income withdrawn from a TFSA.

13. False. Rollover is a term that refers to a transfer of assets on a tax free basis, without regard to whether the transfer was between parties dealing at arm's length.

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

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

16. False. There will be no capital gain.

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

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

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

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

19. False. Any dividends declared on the securities will not be attributed to the father because his daughter is older than 17.

20. False. There is no income attribution for capital gains that are realized on assets that have been transferred to related minors.

TIF Solution Nine - 3

New For 2016/2017

1. A. The $10,000 exclusion from income of a death benefit must be claimed by a spouse.

2. B. Both his Net Income For Tax Purposes and his Taxable Income will be reduced by $2,544. Note that [(15%)($5,088)] = $763 (Answer D).

3. D. The costs of selling a residence where the taxpayer lived prior to the relocation is always deductible.

4. B. Amounts paid to a person under the age of 18 are never deductible. Deduction is permitted provided the person is not related to the taxpayer.

5. D. This deduction is available to individuals who do not qualify for the disability tax credit.

6. B. If an individual and his spouse are in different tax brackets, pension income splitting will always reduce their combined federal Tax Payable.

7. C The recipient of child support payments will not be able to claim the tax credit for an eligible dependant.

8. C. If the taxpayer uses funds from his savings account to purchase an annuity, the taxable amount of any payment is reduced by the capital element that is included in the payment.

9. B. Withdrawals from either plan will be received tax free.

10. C. When there is a non-arm's length transfer of a capital property that has a fair market value that is less than the transferor's capital cost, the transferee's new capital cost is deemed to be equal to the transferor's old capital cost.

11. A. Recapture of $20,000 for Lance and the capital cost of the asset to Paul will be $150,000.

12. C. The transfer of an unincorporated business to a spouse. The transferor does not elect out of ITA 73(1).

Retained From Previous Editions

13. C. While a deduction can be made for transfers to an RRSP, 100 percent of the retiring allowance has to be included in income.

14. C. Workers' compensation payments.

15. C. Yijuin must report the benefit in his income in the year it is received.

16. B. $1,043 [($2,544)(15%) + ($2,544)(26%)]

17. C. He cannot claim the 50 percent of the cost that was reimbursed. Further, the claim can only be made against employment income earned at the new location.

18. A. $8,800 [$5,000 + $2,000 + $750 + (15/30)($2,100)]. Legal fees are not deductible as Mr. Kumar did not own a house prior to moving; house hunting trips are not deductible; costs for temporary accommodation are limited to 15 days.

19. A. $8,500 ($102,000 ÷ 12). The deduction is limited to the income earned at the new location.

20. B. $16,300 ($1,200 + $12,000 + $100 + $200 + $2,800).

21. C. John's claim is limited to $1,600 [($200)(2)(4 months)]. Since Alexandria's attendance is part-time, the sum of the Periodic Amounts is multiplied by the number of months of part-time attendance, not weeks.

22. B. $19,000 [$8,000 + $11,000]. Hinda cannot be claimed as he is not an eligible child due to his income level.

23. A. The deduction is limited to individuals who qualify for the disability tax credit.

24. C. $22,000 [($25,000 - $10,000 - $5,000) + $12,000]

25. C. $36,500 [(1/2)($65,000) + $4,000]

26. D. $42,200 ($35,000 + $7,200). Neither CPP received nor RRSP withdrawals when under 65 can be split.

27. D. None of the above.

28. D. $2,200 [($4,000 - $1,800)]. Deductible spousal support is limited to the $4,000 amount paid, less the required $1,800 for child support.

29. B. $772 [$5,772 – ($25,000 ÷ $28,860)($5,772)]

30. C. There is no limit on the amount of annual contributions that can be made. The limit is on the total amount that can be contributed for each beneficiary.

31. A. Contributions to the plan are deductible.

32. D. Withdrawals of accumulated account earnings will be subject to tax.

33. C. Ms. Eli should invest in the TFSA.

34. C. The contributions are tax deductible up to a maximum of $5,500 for 2016 .

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

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

37. D. Nil

38. A. $57,500. Taxable capital gain = ($240,000 – 225,000) x 50% = $7,500
Recapture = $175,000 – $225,000 = $50,000
$7,500 + 50,000 = $57,500

39. D. She has some unused capital losses.

40. A. $2,000 for Sonya and $750 for her sister. ($18 – 10) x 500 x 50% =$2,000, ($18 – 15) x 500 x 50% = $750

41. B. Hugo has a terminal loss of $3,000 and his son has recapture of CCA of $1,000. Since it is a non-arms' length sale to Hugo's son at a value that is less than Hugo's capital cost, ITA 13(7)(e) deems the son's new capital cost to be equal to the transferor's old capital cost.

42. C. In recording the deemed disposition that occurs when an individual dies, the proceeds of disposition will always be the fair market value of the property. This is not correct in that the proceeds of disposition on a transfer to a spouse will be the deceased's tax values.

43. C. If her daughter later sells the property for $100,000, she will have a capital gain of $10,000. As the daughter will retain Erica's original capital cost, the $10,000 will have to be treated as recapture.

44. A. Capital property that is bequeathed to a spouse is transferred on a rollover basis.

45. C. Any assets transferred to a spouse on death are automatically rolled over with no tax consequences. The automobile is personal use property so the loss is not deductible. The only asset that will affect the final return is the building.

Recapture = $30,000, taxable capital gain = [(1/2)($220,000 - $100,000)] = $60,000. Total = $90,000.

46. C. $240 (compound interest does not attribute).

47. C. A growth fund that invests in corporations with a history of paying minimal dividends and earns its income primarily in the form of capital gains.

48. D. William's Net Income For Tax Purposes is $1,288.

Taxable Capital Gain On Disposition Of Global Inc. [($2,500 - $200)(1/2)]	$1,150
Allowable Capital Loss On Gift - TriStar Limited	Nil
Attribution Of Dividend	138
William's Net Income For Tax Purposes	$1,288

49. D. Hans must elect out of the ITA 73 rollover, Olga must pay consideration equal to fair market value, and the loan must bear interest to be paid within 30 days of the end of each year. Attribution can be avoided as long as the interest rate is at least equal to the prescribed rate.

50. D. Carmen faces a tax liability of $2,574 as a result of her capital gains.

51. A. The gift is to Sandy's long-time business partner.

52. A. Pere will claim the dividends on his tax return and Fils will claim the capital gain on his tax return.

TIF Solution Nine - 4

Exam Exercise Solution Nine - 1 (Moving Expenses)

The analysis here is as follows:

Payment From Employer	$6,000
Acquisition Cost Of New House	(3,250)
House Hunting Trip	(650)
Balance	$2,100
Moving Costs	(8,300)
Lease Penalty	(1,200)
Available Deduction	($7,400)
Income At New Location = Maximum Deduction	6,625
Carry Forward	($ 775)

Since he did not own a house in Halifax, he cannot deduct the $3,250 in costs associated with acquiring the new home in Moncton. Further, there is no provision for deducting the $650 cost of the house hunting trip to Moncton. However, these amounts can be paid for by his employer without creating a taxable benefit.

The maximum moving expense deduction is limited to $6,625, the 2016 income at the new location. The remaining $775 can be carried forward and deducted against income earned at the new location in a subsequent year.

Exam Exercise Solution Nine - 2 (Moving Expenses)

The analysis here is as follows:

Payment From Employer	$ 7,000
House Hunting Trip	(950)
Balance	$ 6,050
Cost Of Selling Windsor House	(7,200)
Moving Costs	(12,600)
Available Deduction	($13,750)
Income At New Location [(2)($54,000 ÷ 12)]	9,000
Carry Forward	($ 4,750)

There is no provision for deducting the $650 cost of the house hunting trip to Moncton. However, this amount can be paid for by her employer without creating a taxable benefit.

The maximum deduction is limited to $9,000, the income earned at the new location. The remaining $4,750 can be carried forward and deducted against income earned at the new location in a subsequent year.

Exam Exercise Solution Nine - 3 (Child Care Expenses)

As Mr. Renaud is the low income spouse, he will have to take the deduction for child care costs. The deduction will be the least of the following amounts:

- The actual costs of $11,200.
- The annual limit of $18,000 [(1)($8,000) + (2)($5,000)].
- $8,000 [(2/3)($12,000)]

The least of these three amounts is $8,000. Note that the universal child care benefit payments are not included in Mr. Renaud's earned income for this purpose.

Exam Exercise Solution Nine - 4 (Child Care Expenses)

As the 18 year old child has a physical infirmity, he is an eligible child for purposes of deducting child care costs. While child care costs are normally deducted by the lower income spouse, the higher income spouse can make the deduction during periods when the lower income spouse is in prison. The amount that can be deducted, however, is limited to $175 per week in the case of the four year old and $100 per week for the other children. Given this, Mr. Anders' deduction is limited as shown in the following calculation:

	Mr. Anders	Mrs. Anders
Actual Payments [(50)($190)]	$ 9,500	$ 9,500
Annual Expense Limit [(1)($8,000) + (2)($5,000)]	$18,000	$18,000
2/3 Of Earned Income		
[(2/3)($69,000)]	$46,000	
[(2/3)($18,000)]		$12,000
Periodic Expense Limit [(6)($200)(1) + (6)($125)(2)]	$ 2,700	N/A

The least of the amounts for Mr. Anders is $2,700. The least of the amounts for Mrs. Anders is $9,500. Mrs. Anders' deduction would be reduced by the $2,700 deducted by Mr. Anders, leaving her with a deduction of $6,800 ($9,500 - $2,700). Note that the universal child care benefit payments are not included in Mrs. Anders' earned income.

Exam Exercise Solution Nine - 5 (Disability Supports Deduction)

As Lara is not eligible for the disability tax credit, she will deduct the cost of full time attendant care under ITA 64. When combined with the other disability support costs and the reimbursement, the qualifying costs total $41,000 ($32,000 + $17,000 - $8,000). As this is less than her income from employment, she will be able to deduct the full amount of these costs as her disability supports deduction.

Exam Exercise Solution Nine - 6 (Pension Income Splitting)

In the absence of pension income splitting, Janice would have Tax Payable of nil [(15%)($7,000) - (15%)($11,474)]. Jerry's Net Income For Tax Purposes, before any OAS clawback, would be $95,000 ($88,000 + $7,000). There would be an OAS clawback of $3,187 [(15%)($95,000 - $73,756)], leaving Jerry with a Net and Taxable Income of $91,813 ($95,000 - $3,187). Based on this figure, his Amount Owing would be calculated as follows:

Tax Of First $90,563		$16,075
Tax On Next $1,250 ($91,813 - $90,563) At 26%		325
Total Before Credits		$16,400
Credits:		
Basic Personal	($11,474)	
Spousal ($11,474 - $7,000)	(4,474)	
Age [$7,125 - (15%)($91,813 - $35,927)	Nil	
Pension	(2,000)	
Spouse's Age	(8,001)	
Total	($25,949)	
Rate	15%	(3,892)
Federal Tax Payable		$12,508
OAS Clawback		3,187
Total Amount Owing		$15,695

If maximum pension splitting is used, it will give both Jerry and Janice Net and Taxable Income of $51,000 [($88,000 ÷ 2) + $7,000]. Since this is below the income threshold, there will be no clawback of OAS for Jerry or Janice. Based on these figures, the Amount Owing for both Jerry or Janice would be the same and calculated as follows:

Tax On First $45,282		$6,792
Tax On Next $5,718 ($51,000 - $45,282) At 20.5%		1,172
Tax Before Credits		$7,964
Credits:		
Basic Personal	($11,474)	
Age [$7,125 - (15%)($51,000 - $35,927)	(4,864)	
Pension	(2,000)	
Total	($18,338)	
Rate	15%	(2,751)
Federal Tax Payable		$ 5,213
OAS Clawback		Nil
Total Amount Owing For Each		$ 5,213

With pension income splitting, the total amount owing by Jerry and Janice would be $10,426 [(2)($5,213)]. This is an improvement of $5,269 over the $15,695 that Jerry would have paid without income splitting. Further savings would be available at the provincial level.

Exam Exercise Solution Nine - 7 (Support Payments)

The total required child support is $8,400 [(7 Months)($1,200)] and Shannon's payments will be allocated to this requirement first. This means that $8,400 of her payments will not be deductible to her or taxable to Leon. The remaining $1,100 ($9,500 - $8,400) will be considered a payment towards spousal support and will be deductible to Shannon and taxable to Leon.

Exam Exercise Solution Nine - 8 (Support Payments)

The required payments for 2016 child support were $12,000 [(12)($1,000)]. Of Barry's total payment of $14,000, this $12,000 amount must be classified as child support, with the $2,000 balance being classified as spousal support. As only spousal support payments are deductible, Barry's 2016 deduction is limited to $2,000. Similarly, only spousal support payments are taxable to the recipient. This means that Mandy will only have to include $2,000 in her 2016 income.

Exam Exercise Solution Nine - 9 (Annuity Payments)

A total of $12,060 [(3)($4,020)] in payments will be received from this annuity. The $4,020 will be included in her annual tax return. However, because the annuity was purchased with after tax funds, she is eligible for a deduction equal to $3,333 [($10,000 ÷ $12,060)($4,020)]. As a result, Ms. Brock's Net Income For Tax Purposes will increase by $687 ($4,020 - $3,333) each year.

Exam Exercise Solution Nine - 10 (Annuity Payments)

Sal will receive total payments of $3,000 [(3)($1,000)]. For 2016, the $1,000 payment received will be included in his Net Income For Tax Purposes. However, because the annuity was purchased with after tax funds, he is entitled to a deduction of $891 [($1,000)($2,673 ÷ $3,000)]. The net increase in Net Income For Tax Purposes will be $109 ($1,000 - $891).

Exam Exercise Solution Nine - 11 (Canada Education Savings Grants)

The total 2015 contributions to Marco's RESP are $1,400 ($1,000 + $400). As this is within the $2,500 limit for contribution eligible for CESGs, the 2015 CESG would be $380 {[(40%)($500)] + [(20%)($1,400 - $500)]}.

For 2016, contributions to Marco's RESP total $4,100 ($2,200 + $1,900). However, at this point, the plan has accumulated only $5,000 [(2)($2,500)] in room for contributions eligible for CESGs. As $1,400 of this was used in 2015, only $3,600 remains for use in 2016. Given this, the 2016 CESG amount would be $820 {[(40%)($500)] + [(20%)($3,600 - $500)]}.

Exam Exercise Solution Nine - 12 (Inadequate Consideration)

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

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

Exam Exercise Solution Nine - 13 (Inadequate Consideration)

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

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

Exam Exercise Solution Nine - 14
(Inter Vivos Transfers To A Common-Law Partner)

The tax consequences for Marilyn and Ellen in each of the two years would be as follows:

2016 For Marilyn There would be no tax consequences for Marilyn.

2017 For Marilyn When Ellen sells the land, the taxable capital gain of $52,500 [(1/2)($190,000 - $85,000)] would be attributed back to Marilyn.

2016 For Ellen The $8,500 in income from the parking lot operation would be included in Ellen's Net Income For Tax Purposes. As this is business income, there would be no attribution.

2017 For Ellen As the taxable capital gain is attributed to Marilyn, there would be no tax consequences for Ellen.

Exam Exercise Solution Nine - 15 (Transfer Of Depreciable Asset To A Spouse)

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

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

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

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

Exam Exercise Solution Nine - 16
(Non-Arm's Length Transfer Of Depreciable Property)

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

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

Exam Exercise Solution Nine - 17
(Non-Arm's Length Transfer Of Depreciable Property)

John Travis When John sells the asset for $295,000, the only tax consequence will be recapture of $50,000 ($245,000 - $295,000).

John's Brother The transfer value ($295,000) is below the capital cost to John ($350,000). Given this ITA 13(7)(e) will deem the capital cost to the brother to be equal to John's capital cost, with the $55,000 ($350,000 - $295,000) excess of the transfer value being treated as deemed CCA. This means that, when the brother sells the asset for $315,000, he will subtract the lesser of the $315,000 proceeds of disposition and the deemed capital cost of $350,000 from the UCC of $295,000. This will result in recapture of $20,000 ($295,000 - $315,000).

Exam Exercise Solution Nine - 18
(Inter Vivos Farm Property Transfer To A Child)

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

With respect to the barn, as there was no consideration given, the transfer would take place at the UCC floor of $90,000. There would be no tax consequences for Mrs. Wong. With respect to her son, he would assume a UCC value of $90,000. However, the old capital cost of $120,000 would be retained, with the $30,000 difference being treated as deemed CCA.

Exam Exercise Solution Nine - 19
(Inter Vivos Farm Property Transfer To A Child)

The $470,000 that was paid for the land is between the $435,000 adjusted cost base floor and the $584,000 fair market value ceiling. This means that the proceeds of disposition would be $470,000, resulting in a taxable capital gain for Martin of $17,500 [(1/2)($470,000 - $435,000)]. The adjusted cost base for the son would also be $470,000.

As no consideration was provided for the barn, the transfer would take place at the UCC floor of $140,000. For Martin, there would be no tax consequences. With respect to the son, he would assume the UCC value of $140,000 and the $165,000 capital cost would be retained, with the $25,000 difference being treated as deemed CCA.

Exam Exercise Solution Nine - 20 (Transfers On Death)

With respect to the transfer to Linda, it would be transferred at its UCC of $74,000 [(1/2)($148,000)]. This would result in no tax consequences on Mr. Norten's final tax return and would give Linda a UCC for the asset of $74,000. However, she would retain the old capital cost of $180,000 with the difference between the two values being treated as deemed CCA.

The transfer to his daughter, Mary, would take place at the fair market value of $122,000. This means that the proceeds of disposition for the two backhoes would be $196,000 ($74,000 + $122,000). Given this, recapture of $48,000 ($148,000 - $196,000) would be included in Mr. Norten's final tax return. Mary would also retain her father's original capital cost of $180,000, but her UCC for the backhoe would be $122,000 with the difference between the two values being treated as deemed CCA.

Exam Exercise Solution Nine - 21 (Transfers On Death)

The transfer to Nancy's spouse Mark would take place at the UCC value of $52,000 [(1/2)($104,000)]. This would result in no tax consequences for Nancy's final tax return. With respect to Mark's tax values, his UCC would $52,000. However, he would retain Nancy's capital cost of $125,000 with the difference between the two values being treated as deemed CCA.

In the case of the transfer to Nick, it would take place at the fair market value of $86,000. This means that the proceeds of disposition for the two assets would be $138,000 ($52,000 + $86,000). This would result in recapture of $34,000 ($104,000 - $138,000) being included in Nancy's final tax return. As was the case with the transfer to Mark, Nick would retain Nancy's capital cost of $125,000 with the difference between the two values being treated as deemed CCA.

Exam Exercise Solution Nine - 22 (Income Attribution - Spouse)

ITA 73(1) provides for a tax free rollover of capital property to a spouse. The tax consequences for Mr. and Mrs. Blue for the two years can be outlined as follows:

- 2015 for Mr. Blue - none.
- 2015 for Mrs. Blue - none.
- 2016 for Mr. Blue - none.
- 2016 for Mrs. Blue - Total income of $10,468. She would have taxable dividends of $4,968 and a taxable capital gain of $5,500 [(1/2)($53,000 - $42,000)] attributed to her.

Exam Exercise Solution Nine - 23 (Income Attribution - Spouse)

ITA 73(1) provides for a tax free rollover of capital property to a spouse. The tax consequences for Mr. and Mrs. London for the two years can be outlined as follows:

- 2015 for Mrs. London - none.
- 2015 for Mr. London - none.
- 2016 for Mrs. London - none.
- 2016 for Mr. London - total income of $11,993. He would have taxable dividends of $2,843 and a taxable capital gain of $9,150 [(1/2)($39,800 - $21,500)] attributed to him.

Exam Exercise Solution Nine - 24 (Income Attribution - Spouse)

The tax consequences for Charlotte and Michael for each of the two years are as follows:

- 2015 for Charlotte - Electing out of ITA 73(1) will require Charlotte to record a taxable capital gain of $6,000 [(1/2)($35,000 - $23,000)].
- 2015 for Michael - none.
- 2016 for Charlotte - Since Michael did not pay the fair market value, taxable dividends of $2,484 [(138%)($1,800)] will be attributed to Charlotte. In addition, a taxable capital gain of $3,500 [(1/2)($42,000 - $35,000)] will be attributed to her.
- 2016 for Michael - none.

Exam Exercise Solution Nine - 25 (Income Attribution - Related Minor)

There is no provision for a tax free transfer of shares to a child. The tax consequences for Tom and Patrick London for the two years can be outlined as follows:

- 2015 for Patrick - none.
- 2015 for Tom - a taxable capital gain of $6,850 [(1/2)($35,200 - $21,500)].
- 2016 for Patrick - a taxable capital gain of $2,300 [(1/2)($39,800 - $35,200)].
- 2016 for Tom - taxable dividends of $2,843 attributed to him.

Exam Exercise Solution Nine - 26 (Income Attribution - Related Minor)

There is no provision for a tax free transfer of shares to a child. Given this, the tax consequences for Charlotte and Vanessa for each of the two years are as follows:

- 2015 for Charlotte - a taxable capital gain of $6,000 [(1/2)($35,000 - $23,000)].
- 2015 for Vanessa - none.
- 2016 for Charlotte - Taxable dividends of $2,484 [(138%)($1,800)] will be attributed to Charlotte.
- 2016 for Vanessa - a taxable capital gain of $3,500 [(1/2)($42,000 - $35,000)].

Exam Exercise Solution Nine - 27 (Income Attribution - Spouse And Related Minor)

The tax consequences are as follows:

2015

- Mr. Cleroux has a taxable capital gain of $10,200 [(1/2)(400)($156 - $105)].
- His son has no tax consequences.
- His wife has no tax consequences.

2016

- Mr. Cleroux has taxable dividends of $6,210 [(400 + 600)($4.50)(138%)] attributed to him from his son and wife.
- Mr. Cleroux has a taxable capital gain of $11,100 [(1/2)(600)($142 - $105)] attributed to him from his wife.
- His son has an allowable capital loss of $2,800 [(1/2)(400)($142 - $156)].
- His wife has no tax consequences.

Exam Exercise Solution Nine - 28 (Income Attribution - Use Of Loans)

Since Mrs. Lafarge does not elect out of ITA 73(1) by including a gain in her 2015 tax return, there will be no tax consequences for either Mr. or Mrs. Lafarge in 2015. In addition, because the transfer is a tax free rollover, the adjusted cost base of the bonds to Mr. Lafarge will be $119,000.

As the loan did not bear interest at market rates, all of the 2016 interest income on the bonds will be attributed to Mrs. Lafarge. In addition to the interest of $5,600, there would be a taxable capital gain of $7,500 [(1/2)($134,000 - $119,000)], which would also be attributed to Mrs. Lafarge. The total addition to Mrs. Lafarge's income for 2016 is $13,100 ($5,600 + $7,500). There will be no tax consequences for Mr. Lafarge in 2016.

Exam Exercise Solution Nine - 29 (Income Attribution - Use Of Loans)

The tax consequences for John and Julie in each of the two years are as follows:

- 2015 for John - John will elect out of ITA 73(1) by recording a taxable capital gain of $2,500 [(1/2)($210,000 - $205,000)].
- 2015 for Julie - None.
- 2016 for John - The $11,000 of interest will be attributed to John. In addition, he will have a taxable capital gain of $3,000 [(1/2)($216,000 - $210,000)]. While Julie provided John with a note, the fact that it did not bear interest means that income attribution still applies.
- 2016 for Julie - None.

TIF Solution Nine - 5A

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

A. 3

B. 7

C. 8

D. 4

E. 9

F. 6

G. 2

H. 5

The two unused definitions are as follows:

Spousal Support = 1

Income Splitting = 10

TIF Solution Nine - 5B

For some terms there is both a 100 percent correct answer and an answer that is close. We have indicated the "close answer" in brackets.

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

A. 5

B. 10

C. 11

D. 6 (not 12)

E. 13 (not 1)

F. 8

G. 3 (not 4)

H. 7

The three unused definitions are as follows:

Spousal Support = 2

Death Benefit = 9

Income Splitting = 14

TIF Solution Nine - 6

Deductible Moving Costs

Costs for food and lodging at or near an old or new residence are limited to a maximum period of 15 days. Note that the 9 days spent travelling to Vancouver are not included in the 15 day total. Since the daily costs for her Montreal stay are higher than those for her Vancouver stay, she claims the 15 day maximum at the Montreal rate.

The deductible moving expenses can be calculated as follows:

House Hunting Trip Hotel And Food (Not Deductible)		Nil
Real Estate Commission - Montreal Home		$27,500
Legal Fees - Montreal Home		800
Other Montreal Home Costs (Not Deductible)		Nil
Storage Costs		2,200
Moving Company Charges		10,200
Hotel In Montreal (15 Nights At $350)		5,250
Food - Maximum (15 Days At $51 Flat Rate)		765
Expenses Of Travel To Vancouver:		
Gas (Using Simplified Method)	Nil	
Quebec Vehicle Rate		
[(4,558 @ $0.505)	$2,302	
Hotel (9 Nights - Total)	1,575	
Food (9 Days At $51 Flat Rate)	459	4,336
Vancouver Hotel		Nil
Moving Expense Deductions Available		$51,051

Part A - Costs Paid By Vancouver Office

Moving costs can only be deducted against "income earned at the new work location". This raises the question as to whether the $60,000 that was provided to cover moving costs would be considered to be "earned at the new location". It would be our view that since it was paid by the Vancouver office subsequent to Michelle commencing work at that location, it would qualify.

Salary At New Location (One Month @ $15,000)	$15,000
General Moving Allowance	20,000
Compensation For Loss On Montreal Residence (Note 1)	30,000
Payment For Higher Housing Costs (Note 2)	10,000
Total Employment Income At New Location	$75,000

Note 1 Under ITA 6(20), one-half of any housing loss reimbursement in excess of $15,000 must be included in income. As the total reimbursement was $75,000 ($625,000 - $550,000), the inclusion would be $30,000 [(1/2)($75,000 - $15,000)].

Note 2 Any amounts paid to compensate an employee for higher housing costs must be included in income in full.

As the deductible costs are less than the income at the new location, they are fully deductible in Michelle's 2016 tax return. There would be no carry forward of moving costs.

Part B - Costs Paid By Montreal Office

If the $60,000 had been paid prior to December out of funds provided from the Montreal office, it would not be considered "earned at the new work location". Under this scenario, only $15,000 in moving costs would have been deductible in 2016, with the remaining $36,051 ($51,051 - $15,000) carried forward to subsequent years.

TIF Solution Nine - 7

Income At New Location

As both the general moving allowance and the compensation for the housing loss were paid for by the Ottawa office, these would likely be considered income at the new location. Given this view, Lawrence's employment income at the new location can be calculated as follows:

General Moving Allowance	$18,000
Compensation For Loss On Halifax Residence (Note 1)	7,500
Salary At New Location (1 Month At $8,000)	8,000
Total Employment Income At New Location	$33,500

Note 1 Under ITA 6(20), one-half of any housing loss reimbursement in excess of $15,000 must be included in income. As the total reimbursement was $30,000, the inclusion would be $7,500 [(1/2)($30,000 - $15,000)].

Deductible Expenses

Deductible moving expenses can be calculated as follows:

Real Estate Commission - Halifax Home	$21,000
Legal Fees - Halifax Home	800
Other Halifax Home Costs (Not Deductible)	Nil
Car Moving Costs	1,100
Moving Company Costs ($3,500 + $1,200)	4,700
Costs Of Lodging (Note 2):	
House Hunting Trip (4 Nights At $200)	800
In Ottawa (11 Nights At $160)	1,760
Food - Maximum (15 Days At $51 Flat Rate)	765
Costs Of Airfare On Move To Ottawa	600
Moving Expense Deductions Available	$31,525

Note 2 As soon as the lease is signed (assuming that the person doesn't back out before the lease actually begins) the premises is a new residence. Costs of food and lodging at or near the old or new residence are limited to a maximum period of 15 days.

Lawrence has a total of 23 eligible days, 4 days after he signs a lease at $200 per day and 19 days at $160 per day prior to the delivery of his furnishings. Since the daily costs are higher during the house hunting trip, he claims them in order to maximize his moving expense deduction. Lawrence can claim the lodging costs of $800 [(4)($200)] for the 4 days after the lease is signed. The costs for the remaining 11 days total $1,760 [(11)($160)].

Actual Deduction

As the deductible costs are less than the income at the new location, they are fully deductible in Lawrence's 2016 tax return. There would be no carry forward of moving costs.

TIF Solution Nine - 8

Mrs. Fortin

Generally, the spouse with the lower income must claim the deduction for child care expenses. However, under certain circumstances, for example if this spouse is hospitalized, the spouse with the higher income can claim the deduction for the period of hospitalization. Thus Mrs. Fortin can claim the least of the following:

	Case A	Case B
Actual Payments [($400)(48)]	$ 19,200	$19,200
2/3 Of Earned Income [(2/3)($84,000)]	$56,000	$56,000
Annual Expense Limit:		
Case A [(2)($8,000)]	$16,000	
Case B [(2)($8,000) + (1)($5,000)]		$21,000
Periodic Expense Limit:		
Case A [(2)($200)(6 weeks)]	$ 2,400	
Case B {[(2)($200)(6 weeks)] + [(1)($125)(6 weeks)]}		$ 3,150

In Case A, the least of these figures is $2,400, the Periodic Expense Limit. In Case B, the least of the figures is $3,150, also the Periodic Expense Limit.

Mr. Fortin

The calculations for Mr. Fortin are as follows:

	Case A	Case B
Actual Payments	$19,200	$19,200
2/3 Of Earned Income [(2/3)($8,000)]*	$ 5,333	$ 5,333
Annual Expense Limit:		
Case A [(2)($8,000)]	$16,000	
Case B [(2)($8,000) + (1)($5,000)]		$21,000

*The universal child care benefit payments are not included in Mr. Fortin's earned income for this purpose.

The lowest figure in both cases is $5,333, two-thirds of Mr. Fortin's earned income. Mr. Fortin's deduction for the current year will be reduced by the amount claimed by Mrs. Fortin. Mr. Fortin's deduction for the current year is $2,933 ($5,333 - $2,400) in Case A, and $2,183 ($5,333 - $3,150) in Case B.

TIF Solution Nine - 9

Mrs. Holmes

Generally, the spouse with the lower income must claim the deduction for child care expenses. However, under certain circumstances, for example if this spouse is a full time student, the spouse with the higher income can claim the deduction for the period the spouse is a student. Under this provision, Mrs. Holmes can claim the least of the following:

	Case A	Case B
Actual Payments [($300)(50)]	$15,000	$15,000
2/3 Of Earned Income* [(2/3)($81,000)]	$54,000	$54,000
Annual Expense Limit:		
Case A [(2)($8,000)]	$16,000	
Case B [(2)($8,000) + (1)($5,000)]		$21,000
Periodic Expense Limit:		
Case A [(2)($200)(6 weeks)]	$ 2,400	
Case B {[(2)($200)(6 weeks)] + [(1)($125)(6 weeks)]}		$ 3,150

*The employment income figure used for this purpose is gross and not net employment income.

In Case A, the least of these figures is $2,400, the Periodic Expense Limit.

In Case B, the least of the figures is $3,150, also the Periodic Expense Limit.

Mr. Holmes

The calculations for Mr. Holmes are as follows:

	Case A	Case B
Actual Payments	$15,000	$15,000
2/3 Of Earned Income [(2/3)($18,000)]*	$12,000	$12,000
Annual Expense Limit:		
Case A [(2)($8,000)]	$16,000	
Case B [(2)($8,000) + (1)($5,000)]		$21,000

*The universal child care benefit payments are not included in Mr. Holmes' earned income for this purpose.

The lowest figure in both cases is $12,000, two-thirds of Mr. Holmes' earned income. Mr. Holmes' deduction is reduced by the amount claimed by Mrs. Holmes.

Given this, Mr. Holmes' deduction is:

- $9,600 ($12,000 - $2,400) in Case A, and
- $8,850 ($12,000 - $3,150) in Case B.

TIF Solution Nine - 10

Part A - Net And Taxable Income

Martin's Income	Scenario 1	Scenario 2
Pension Receipt	$124,000	$124,000
Pension Income To Sally	N/A	(62,000)
OAS	N/A	7,000
Net Income Before OAS Clawback	$124,000	$ 69,000
OAS Clawback (Notes 1 and 2)	N/A	N/A
Net And Taxable Income - Martin	$124,000	$ 69,000

Sally's Income	Scenario 1	Scenario 2
OAS	$ 7,000	$ 7,000
Interest Earned	43,000	43,000
Pension Income From Martin	N/A	62,000
Net Income Before OAS Clawback	$50,000	$112,000
OAS Clawback (Note 3)	Nil	(5,737)
Net And Taxable Income - Sally	$50,000	$106,263

Note 1 As Martin did not apply for OAS in Scenario 1, there can be no clawback.

Note 2 In Scenario 2, Martin's Net Income is less than the clawback income threshold of $73,756 so there is no clawback.

Note 3 With pension income splitting, the OAS clawback for Sally would be $5,737 [(15%)($112,000 - $73,756)].

Part B - Scenario 1

Without pension income splitting, Martin's Amount Owing would be calculated as follows:

Tax On First $90,563		$16,075
Tax On Next $33,437 ($124,000 - $90,563) At 26%		8,694
Tax Before Credits		$24,769
Credits:		
Basic Personal	($11,474)	
Age [$7,125 - (15%)($124,000 - $35,927)	Nil	
Pension	(2,000)	
Total	($13,474)	
Rate	15%	(2,021)
Federal Tax Payable		$22,748
OAS Clawback		N/A
Total Amount Owing - Martin		$22,748

Without pension income splitting, Sally's Amount Owing would be calculated as follows:

Tax On First $45,282		$6,792
Tax On Next $4,718 ($50,000 - $45,282) At 20.5%		967
Tax Before Credits		$7,759
Credits:		
Basic Personal	($11,474)	
Age [$7,125 - (15%)($50,000 - $35,927)	(5,014)	
Disability	(8,001)	
Total	($24,489)	
Rate	15%	(3,673)
Total Amount Owing (No Clawback) - Sally		$4,086

Part B - Scenario 2

With pension income splitting and the OAS payments, Martin's Amount Owing would be calculated as follows:

Tax On First $45,282		$6,792
Tax On Next $23,718 ($69,000 - $45,282) At 20.5%		4,862
Tax Before Credits		$11,654
Credits:		
Basic Personal	($11,474)	
Age [$7,125 - (15%)($69,000 - $35,927)]	(2,164)	
Pension	(2,000)	
Total	($15,638)	
Rate	15%	(2,346)
Total Amount Owing (No Clawback) - Martin		$ 9,308

With pension income splitting, Sally's Amount Owing would be calculated as follows:

Tax On First $90,563		$16,075
Tax On Next $15,700 ($106,263 - $90,563) At 26%		4,082
Tax Before Credits		$20,157
Credits:		
Basic Personal	($11,474)	
Age [$7,125 - (15%)($106,263 - $35,927)]	Nil	
Disability	(8,001)	
Pension	(2,000)	
Total	($21,475)	
Rate	15%	(3,221)
Federal Tax Payable		$16,936
OAS Clawback		5,737
Total Amount Owing - Sally		$22,673

Part B - Comparison Of After Tax Income

This amount would be calculated as follows:

Amount Owing - Scenario 1 ($22,748 + $4,086)		$26,834
Amount Owing - Scenario 2 ($9,308 + $22,673)	($31,981)	
OAS Benefits Received - Scenario 2	7,000	(24,981)
Cash Advantage - Scenario 2		$ 1,853

This problem illustrates the complexity associated with pension income splitting. Although Scenario 2 served to make the incomes more equal, it had several negative side effects (e.g., the clawback of a large part of Sally's OAS, as well as the elimination of her age credit.) However, there is a definite cash advantage to Scenario 2.

The result would be improved if pension income splitting was limited to an amount that would give Martin a Net Income of the OAS clawback income threshold as that would reduce Sally's OAS clawback without clawing back his OAS. However, that may not be the best solution. Finding the optimum solution is not an intuitive process, especially if there are other factors such as medical costs, and would require the use of tax software.

TIF Solution Nine - 11

Part A - Net And Taxable Income

Bennett's Income	Alternative 1	Alternative 2
Pension Receipt	$120,000	$120,000
Pension Income To Belinda	N/A	(60,000)
OAS	N/A	7,000
Net Income Before OAS Clawback	$120,000	$ 67,000
OAS Clawback (Notes 1 and 2)	N/A	N/A
Net And Taxable Income	$120,000	$ 67,000

Belinda's Income	Alternative 1	Alternative 2
OAS	$ 7,000	$ 7,000
Eligible Dividends Received	39,000	39,000
Gross Up [(38%)($39,000)]	14,820	14,820
Pension Income From Bennett	N/A	60,000
Net Income Before OAS Clawback	$60,820	$120,820
OAS Clawback (Note 3)	Nil	(7,000)
Net And Taxable Income	$60,820	$113,820

Note 1 As Bennett did not apply for OAS in Alternative 1, there can be no clawback. Belinda's income is below the OAS clawback threshold of $73,756.

Note 2 In Alternative 2, Bennett's Net Income is less than the clawback income threshold of $73,756 so there is no clawback.

Note 3 With pension income splitting, the OAS clawback for Belinda would be the lesser of $7,000 and $7,060 [(15%)($120,820 - $73,756)].

Part B - Alternative 1

Without pension income splitting, Bennett's Amount Owing would be calculated as follows:

Tax On First $90,563		$16,075
Tax On Next $29,437 ($120,000 - $90,563) At 26%		7,654
Total Before Credits		$23,729
Credits:		
Basic Personal	($11,474)	
Age [$7,125 - (15%)($120,000 - $35,927)	Nil	
Pension	(2,000)	
Total	($13,474)	
Rate	15%	(2,021)
Federal Tax Payable		$21,708
OAS Clawback		N/A
Total Amount Owing - Bennett		$21,708

Without pension income splitting, Belinda's refund would be calculated as follows:

Tax On First $45,282		$6,792
Tax On Next $15,538 ($60,820 - $45,282 At 20.5%		3,185
Total Before Credits		$9,977
Credits:		
Basic Personal	($11,474)	
Age [$7,125 - (15%)($60,820 - $35,927)	(3,391)	
Total	($14,865)	
Rate	15%	(2,230)
Dividend Tax Credit [(6/11)($14,820)]		(8,084)
Total Amount Owing - No Clawback - Belinda		Nil

Part B - Alternative 2

With pension income splitting and the OAS payments, Bennett's Amount Owing would be calculated as follows:

Tax On First $45,282		$ 6,792
Tax On Next $21,718 ($67,000 - $45,282) At 20.5%		4,452
Tax Before Credits		$11,244
Credits:		
Basic Personal	($11,474)	
Age [$7,125 - (15%)($67,000 - $35,927)]	(2,464)	
Pension	(2,000)	
Total	($15,938)	
Rate	15%	(2,391)
Total Amount Owing - No Clawback - Bennett		$ 8,853

With pension income splitting, Belinda's Amount Owing would be calculated as follows:

Tax On First $90,563		$16,075
Tax On Next $23,257 ($113,820 - $90,563) At 26%		6,047
Tax Before Credits		$22,122
Credits:		
Basic Personal	($11,474)	
Age [$7,125 - (15%)($113,820 - $35,927)]	Nil	
Pension	(2,000)	
Total	($13,474)	
Rate	15%	(2,021)
Dividend Tax Credit [(6/11)($14,820)]		(8,084)
Federal Tax Payable		$12,017
OAS Clawback		7,000
Total Amount Owing - Belinda		$19,017

Part B - Comparison Of After Tax Income

This amount would be calculated as follows:

Amount Owing - Alternative 1		$21,708
Amount Owing - Alternative 2 ($8,853 + $19,017)	($27,870)	
OAS Benefits Received - Alternative 2	7,000	(20,870)
Cash Advantage (Disadvantage) - Alternative 2		$ 838

This problem illustrates the complexity associated with pension income splitting. By splitting the $120,000 in pension income on an equal basis, Belinda became the higher income spouse by a significant amount. As a result, Bennett had no OAS clawback, but Belinda had all of her OAS clawed back.

Although there is a cash advantage to Alternative 2, the result would be improved if pension income splitting was limited to an amount that would give Bennett a Net Income of the OAS clawback income threshold as that would reduce Belinda's OAS clawback without clawing back his OAS.

However, that may not be the best solution. Finding the optimum solution is not an intuitive process, especially if there are other factors such as medical costs, and would require the proper use of tax software.

TIF Solution Nine - 12

Part A - Net Income For Tax Purposes

The minimum Net Income For Tax Purposes that can be reported by Ms. Watts is calculated as follows:

Universal Child Care Benefits		$ 720
Wages From Cold Lake Employment	$9,600	
Moving Costs To Cold Lake (Note 1)	(685)	8,915
Scholarship Received	$4,000	
Exempt Portion Of Scholarship (100%)	(4,000)	Nil
Child Care Costs (Note 2)		(1,500)
Employment Income In Calgary	$600	
Moving Costs To Calgary (Note 1)	(600)	Nil
Eligible Dividends Received		3,500
Gross Up Of Dividends [(38%)($3,500)]		1,330
Child Support Received (Note 3)		Nil
Inheritance (Not Taxable)		Nil
TFSA Contributions (Note 4)		Nil
TFSA Withdrawal (Note 4)		Nil
RESP Contributions (Note 5)		Nil
Net Income For Tax Purposes		$12,965

Note 1 The cost of the move to Cold Lake is deductible against the income that was earned there as it is more than 40 km from Calgary. The moving costs related to the move back to Calgary can be deducted to the extent of her employment income at that location. The remaining $226 ($826 - $600) can be carried forward to apply against any eligible income that is earned in Calgary during 2017.

Note 2 As she is the lower income spouse, Ms. Watts will deduct the child care payments. The deduction is the least of the following amounts:

- The amount paid = $1,500 [(12)($125)].
- The annual child care expense amount = $10,000 [(2)($5,000)].
- Two-thirds of Earned Income = $6,800 [(2/3)($9,600 + $600)].

Note that the Universal Child Care Benefits are not included in earned income.

Note 3 Child support payments are not deductible to the payor and are not taxed in the hands of the recipient.

Note 4 TFSA contributions and withdrawals have no tax consequences. There is also no income attribution as a result of the TFSA contribution by Ms. Watts' husband.

Note 5 Contributions to RESPs are not deductible.

Part B - Registered Education Savings Plan

While contributions to RESPs are not deductible, earnings within the plan accumulate on a tax free basis. Further, when the earnings are withdrawn, they are likely to be taxed in the hands of the plan beneficiaries. As they will be full or part time students at this time, they will either be in a low tax bracket or, in many cases, have income that is below the basic personal tax credit. This arrangement can involve a considerable savings in taxes.

In addition, for contributions of up to $2,500 per year, the federal government will make additional contributions under the Canada Education Savings Grants (CESG) program. These contributions will add a minimum of $500 to the first $2,500 of annual contributions. Note, however, that given her husband's level of income, the family will not be eligible for the Canada Learning Bonds program.

Given the potential tax savings, as well as the federal government contributions under the CESG program, Ms. Watts and her husband should consider contributing at least $2,500 per year to each of the children's RESPs.

Since her children have not had RESPs before, they have CESG contribution room carried forward. Ms. Watts should determine the contribution schedule required to maximize the CESGs for both children so that she can plan to take advantage of the CESG contribution room if there are sufficient funds available.

TIF Solution Nine - 13

Part A - Case 1 - Sale To Arm's Length Party

The result for Martin would be as follows:

Proceeds Of Disposition	$500,000
Adjusted Cost Base	(360,000)
Capital Gain	$140,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 70,000

With respect to the subsequent sale by the arm's length purchaser, the results for that individual would be as follows:

Proceeds Of Disposition	$500,000
Adjusted Cost Base	(500,000)
Capital Gain	Nil

Part A - Case 2 - Sale To Sister

The result for Martin would be as follows:

Deemed Proceeds Of Disposition - ITA 69(1)(b)	$500,000
Adjusted Cost Base	(360,000)
Capital Gain	$140,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 70,000

With respect to the subsequent sale by Martin's sister, the results for her would be as follows:

Proceeds Of Disposition (Actual)	$500,000
Adjusted Cost Base	(360,000)
Capital Gain	$140,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 70,000

Note that in this case the $140,000 capital gain is subject to double taxation.

Part A - Case 3 - Gift To Son

The result for Martin would be as follows:

Deemed Proceeds Of Disposition - ITA 69(1)(b)	$500,000
Adjusted Cost Base	(360,000)
Capital Gain	$140,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 70,000

With respect to the subsequent sale by Martin's son, the results for him would be as follows:

Proceeds Of Disposition	$500,000
Adjusted Cost Base (Actual)	(500,000)
Capital Gain	Nil

The fact that his son is younger than 18 years of age does not affect the results.

Part A - Case 4 - Sale To Mother

The result for Martin would be as follows:

Proceeds Of Disposition (Actual)	$600,000
Adjusted Cost Base	(360,000)
Capital Gain	$240,000
Inclusion Rate	1/2
Taxable Capital Gain	$120,000

With respect to the subsequent sale by Martin's mother, the results for her would be as follows:

Proceeds Of Disposition (Actual)	$500,000
Adjusted Cost Base - ITA 69(1)(a)	(500,000)
Capital Gain	Nil

Despite the fact that Martin had to record the actual proceeds of $600,000, his mother's adjusted cost base will be the fair market value of $500,000. This means that she did not have a $100,000 capital loss to economically offset (for the family unit) the effect of his capital gain.

Part B

In Case 2, the sale was for $360,000, less than the $500,000 fair market value of the asset. Martin might agree to do this in an attempt to transfer the $140,000 gain to his sister. This could be motivated by the fact that she is in a lower tax bracket. It could also reflect the fact that she has unused capital losses that she would like to be able to use.

In Case 4, the sale was for $600,000, more than the $500,000 fair market value of the asset. The motivation here could be that his mother has capital gains that she would like to offset with a capital loss resulting from her re-selling the asset for $500,000 and/or Martin has unused capital losses greater than $140,000 that he would like to be able to use.

TIF Solution Nine - 14

Case One - FMV > Transferor's Capital Cost

The results of the disposition for John can be calculated as follows:

UCC Balance	$69,000
Lesser Of:	
Proceeds Of Disposition = $165,000	
Capital Cost = $97,000	(97,000)
Negative Ending UCC Balance = Recapture Of CCA	($28,000)

Proceeds Of Disposition	$165,000
Capital Cost	(97,000)
Capital Gain	$ 68,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 34,000

John's Net Income For Tax Purposes will increase by $62,000 ($28,000 + $34,000).

For his son, his capital cost for capital gains purposes will be the transfer price of $165,000. However, because the fair market value of the asset exceeded its original capital cost, ITA 13(7)(e) will limit the value used for CCA and recapture calculations to the following amount:

[$97,000 + (1/2)($165,000 - $97,000)] = $131,000

Case Two - FMV < Transferor's Capital Cost

The results of this disposition for John can be calculated as follows:

UCC Balance	$189,000
Lesser Of:	
Proceeds Of Disposition = $210,000	
Capital Cost = $286,000	(210,000)
Negative Ending UCC Balance = Recapture Of CCA	($ 21,000)

John's Net Income For Tax Purposes will increase by $21,000.

In this case, where the fair market value of the asset is less than its capital cost, ITA 13(7)(e) deems the transferee's capital cost of the transferred asset to be equal to the transferor's capital cost, an amount of $286,000. This capital cost will be used for purposes of determining any capital gain and/or recapture on a future disposition.

The $76,000 ($286,000 - $210,000) difference between this value and the transfer price will be considered deemed CCA. The resulting UCC balance of $210,000 will be used by John's daughter for calculating future CCA.

Since John was taxed on the $21,000 difference between his UCC of $189,000 and the fair market value of $210,000 as recapture, it makes economic sense that his daughter's UCC balance should be $210,000.

TIF Solution Nine - 15

Note To Instructor Part B of this problem requires knowledge of ITA 13(21.1) as there is a capital gain on the land and a terminal loss on the building. This provision is covered in detail in Chapter 8.

Case A(1)

Assuming that the transfer was to Margarette's spouse, the land would have been transferred at its cost and the building would have been transferred at its UCC. As a consequence, there would have been no tax effects to be included in Margarette's final return.

For CCA purposes, the building would have been transferred at Margarette's UCC of $363,000. Given this, maximum CCA would be $14,520 [(4%)($363,000)] for 2016 leaving a UCC of $348,480. Since the acquisition of the building is a non-arm's length transaction, it was used and continues to be used to produce income and was owned for more than one year by Margarette, the half year rule does not apply to Gianni.

Note, however, that after the transfer, Gianni would have retained the building's old capital cost of $473,000. Using this figure for the building, the tax effects that would occur at the time of the 2017 sale of the property would be as follows:

	Land	Building
Proceeds Of Disposition	$160,000	$525,000
Adjusted Cost Base/Capital Cost	(150,000)	(473,000)
Capital Gain	$ 10,000	$ 52,000
Inclusion Rate	1/2	1/2
Taxable Capital Gain	$ 5,000	$ 26,000

UCC	$348,480
Deduct Disposition - Lesser Of:	
• Capital Cost = $473,000	
• Proceeds Of Disposition = $525,000	(473,000)
Negative Closing UCC Balance = Recaptured CCA	($124,520)

A total of $155,520 ($5,000 + $26,000 + $124,520) would be added to the 2017 Net Income For Tax Purposes of Gianni. With the death of Margarette, there can be no income or capital gains attributed to her from Gianni.

Case A(2)

As the transfer was to her daughter, Ciara, the deemed proceeds will be recorded at fair market value for the land and building. Based on this, the following calculations show the tax effects that will be included in Margarette's final return:

	Land	Building
Deemed Proceeds	$175,000	$571,000
Adjusted Cost Base/Capital Cost	(150,000)	(473,000)
Capital Gain	$ 25,000	$ 98,000
Inclusion Rate	1/2	1/2
Taxable Capital Gain	$ 12,500	$ 49,000

UCC	$363,000
Deduct Disposition - Lesser Of:	
• Capital Cost = $473,000	
• Deemed Proceeds = $571,000	(473,000)
Negative Closing UCC Balance = Recaptured CCA	($110,000)

A total of $171,500 ($12,500 + $49,000 + $110,000) would be added to Margarette's 2016 Net Income For Tax Purposes.

With respect to Ciara's tax records, the land will have a tax cost of $175,000 and the building will be a Class 1 asset with a tax cost equal to Margarette's deemed proceeds of $571,000.

Maximum 2016 CCA is $22,840 [($571,000)(4%)], leaving a UCC of $548,160 ($571,000 - $22,840). Since the acquisition of the building is a non-arm's length transaction, it was used and continues to be used to produce income and was owned for more than one year by Margarette, the half year rule does not apply to Ciara. In addition, ITA 13(7)(e), which requires the calculation of a limited UCC balance, is not applicable to transfers at death.

Since there cannot be a capital loss on depreciable property and the building is the only asset in the class, the 2017 tax effects associated with the sale of the building would be calculated as follows:

	Land	Building
Proceeds Of Disposition	$160,000	$525,000
Adjusted Cost Base	(175,000)	
Capital Cost Limited To Proceeds		(525,000)
Capital Gain (Loss)	($ 15,000)	Nil
Inclusion Rate	1/2	N/A
Allowable Capital Loss	($ 7,500)	Nil

UCC	$548,160
Deduct Disposition - Lesser Of:	
• Capital Cost = $571,000	
• Proceeds Of Disposition= $525,000	(525,000)
Positive Closing UCC Balance = Terminal Loss	$ 23,160

A total of $30,660 ($23,160 + $7,500) would be deducted from the 2017 Net Income For Tax Purposes of Ciara as the problem indicates that she has sufficient income and taxable capital gains.

Comparison Case A(1) And A(2)

The overall tax consequences in the two cases are as shown in the following table:

	Case A(1) Gianni	Case A(2) Margarette	Case A(2) Ciara
2016	Nil	$171,500	Nil
2016 - CCA Taken	($ 14,520)		($22,840)
2017	155,520		(30,660)
Net Income For Tax Purposes (Loss)	$141,000	$171,500	($53,500)

There is a difference in the Case A(1) and Case A(2) results of $23,000 [$141,000 - ($171,500 - $53,500)]. This reflects the fact that, in Case A(2), a portion of the amount that was taxed as a capital gain (50 percent) in Margarette's final return was deducted by Ciara as CCA and a terminal loss (100 percent).

This can be shown in the following calculation:

Actual Sale Price Of Building For Ciara	$525,000
Fair Market Value (Deemed Proceeds) At Death	(571,000)
Amount Deducted By Ciara As CCA And Terminal Loss*	($ 46,000)
Portion Taxed As Capital Gain In Final Return [(1/2)($46,000)]	23,000
Difference	($ 23,000)

*$23,160 + $22,840 = $46,000

Part B

If the proceeds of the sale of the property by Ciara were allocated $300,000 to the land and $385,000 to the building, the tax effects associated with the sale of the building would be initially calculated as follows:

	Land	Building
Proceeds Of Disposition	$300,000	$385,000
Adjusted Cost Base	(175,000)	
Capital Cost Limited To Proceeds		(385,000)
Capital Gain	$125,000	Nil
Inclusion Rate	1/2	1/2
Taxable Capital Gain	$ 62,500	Nil

UCC	$548,160
Deduct Disposition - Lesser Of:	
• Capital Cost = $571,000	
• Proceeds Of Disposition= $385,000	(385,000)
Positive Closing UCC Balance = Terminal Loss	$163,160

Since there is a capital gain on the land and a terminal loss on the building, ITA 13(21.1)(a) requires the deemed proceeds of disposition for the building to be determined as follows:

The Lesser Of:

• The FMV of the land and building	$685,000	
Reduced By The Lesser Of:		
• The ACB of the land = $175,000		
• The FMV of the land = $300,000	(175,000)	$510,000
• The Greater Of:		
• The FMV of the building = $385,000		
• The Lesser Of:		
The cost of the building = $571,000		
The UCC of the building = $548,160		$548,160

The proceeds that would be allocated to the building would be $510,000, leaving $175,000 ($685,000 - $510,000) to be allocated to the land. The net result is that the terminal loss would be reduced by $125,000 (the amount of the potential capital gain) to $38,160 ($510,000 - $548,160) and the capital gain would be nil ($175,000 - $175,000).

TIF Solution Nine - 16

Case A

Whenever a taxpayer dies, there is a deemed disposition of all of his property. If the transfer is to a spouse, the disposition is deemed to have taken place at the adjusted cost base of capital property other than depreciable property, and at the UCC of depreciable property. This would mean that there would be no immediate tax consequences associated with Mr. Cheever's death in this Case, since all of the property is transferred to his spouse. Note, however, that on a subsequent disposition by Mr. Cheever's spouse, her tax base would be the same as Mr. Cheever's. Although fair market value elections are available, the problem states that none were made.

Case B

This Case is more complex and would follow the general rules applicable to transfers made at death to anyone other than a spouse. Such transfers, unless they involve farm property, will be deemed to have taken place at fair market value.

Farm Land In the case of farm land that is being used by the taxpayer or a member of his family, ITA 70(9.01) permits a tax free transfer of such property to a child. The deemed proceeds would be Mr. Cheever's adjusted cost base, resulting in no tax consequences for his estate. As you would expect, the adjusted cost base to Mr. Cheever's daughter, Mary, would be the same $525,000 that was deemed to be the proceeds of the disposition on Mr. Cheever's death.

Rental Property In the case of the rental property, the tax consequences to Mr. Cheever's estate would be as follows:

	Land	Building
Deemed Proceeds	$100,000	$870,000
Adjusted Cost Base/Capital Cost	(100,000)	(450,000)
Capital Gain	Nil	$420,000
Inclusion Rate	N/A	1/2
Taxable Capital Gain	Nil	$210,000

UCC	$270,000
Deduct Disposition - Lesser Of:	
• Capital Cost ($550,000 - $100,000) = $450,000	
• Deemed Proceeds ($970,000 - $100,000) = $870,000	(450,000)
Negative Closing UCC Balance = Recaptured CCA	($180,000)

Shares In the case of the Brazeway Dynamics shares and the shares of Cheever Inc., the deemed proceeds would be the fair market value and the tax consequences to Mr. Cheever's estate would be as follows:

	Brazeway Dynamics	Cheever Inc.
Deemed Proceeds	$425,000	$227,000
Adjusted Cost Base/Capital Cost	(275,000)	(155,000)
Capital Gain	$150,000	$ 72,000
Inclusion Rate	1/2	1/2
Taxable Capital Gain	$ 75,000	$ 36,000

This gives a total increase in Net Income For Tax Purposes for Mr. Cheever of $501,000 ($210,000 + $180,000 + $75,000 + $36,000).

Case C

With respect to the departure from Canada, ITA 128.1(4)(b) indicates that when a taxpayer ceases to be a resident of Canada, he is deemed to have disposed of all property except real property, property of a business carried on in Canada by an individual, and excluded personal property [a variety of items specified in ITA 128.1(9)]. This means that, of the property listed in the problem, only the rental property and the farm land would be exempt.

Given this, there would be a deemed disposition of both the Brazeway Dynamics shares and the Cheever Inc. shares. The results would be as follows:

	Brazeway Dynamics	Cheever Inc.
Deemed Proceeds	$425,000	$227,000
Adjusted Cost Base	(275,000)	(155,000)
Capital Gain	$150,000	$ 72,000
Inclusion Rate	1/2	1/2
Taxable Capital Gain	$ 75,000	$ 36,000

This gives a total increase in Net Income For Tax Purposes of $111,000 ($75,000 + $36,000).

TIF Solution Nine - 17

Part A

In the absence of an election by James not to have ITA 73(1) apply, the disposition will be deemed to have taken place at his tax values. These would be the $52,000 adjusted cost base of the land and the $97,000 UCC for the building. Note, however, the transferee would retain the original capital cost of $170,000. Given this information, the transfer would not result in any tax effects for either James Hadley or Gwyneth Rowe.

As James did not elect out of ITA 73(1), the net rental loss for 2016 of $7,400 would be attributed to him.

When the property is sold on January 1, 2017, the income from the sale of the property would also be attributed to James. The relevant amount would be as follows:

	Land	Building
Proceeds Of Disposition	$102,000	$244,000
Adjusted Cost Base	(52,000)	(170,000)
Capital Gain	$ 50,000	$ 74,000
Inclusion Rate	1/2	1/2
Taxable Capital Gain	$ 25,000	$ 37,000
Capital Cost		$170,000
UCC		(97,000)
Recapture Of CCA		$ 73,000

This would result in an increase in James Hadley's 2017 Net Income For Tax Purposes of $135,000 ($25,000 + 37,000 + $73,000).

There would be no effect on Gwyneth's Net Income For Tax Purposes in either year.

Part B

The preceding result would be changed if Gwyneth agrees to purchase the property at its fair market value. Provided James elects out of ITA 73(1), there will be no income attribution. Under this approach, the transfer would result in the following amounts of income for James.

	Land	Building
Deemed Proceeds Of Disposition	$102,000	$214,000
Adjusted Cost Base	(52,000)	(170,000)
Capital Gain	$ 50,000	$ 44,000
Inclusion Rate	1/2	1/2
Taxable Capital Gain	$ 25,000	$ 22,000
Capital Cost		$170,000
UCC		(97,000)
Recapture Of CCA		$ 73,000

This would result in an increase in James Hadley's 2016 Net Income For Tax Purposes of $120,000 ($25,000 + $22,000 + $73,000).

In the absence of income attribution, all of the net rental loss will be included in Gwyneth's 2016 Net Income For Tax Purposes. In addition, the income resulting from the January 1, 2017 sale of the property would be included in her income. The relevant amounts would be as follows:

	Land	Building
Proceeds Of Disposition	$102,000	$244,000
Adjusted Cost Base	(102,000)	(214,000)
Capital Gain	Nil	$ 30,000
Inclusion Rate	N/A	1/2
Taxable Capital Gain	Nil	$ 15,000

You might wish to note that, while the allocation of the income differs in Part A and Part B, the total amount of income is the same. This is shown in the following tables:

	Part A
James For 2016	
Net Rental Loss	($ 7,400)
James For 2017	
Taxable Capital Gains ($25,000 + $37,000)	62,000
Recapture	73,000
Total (No Income For Gwyneth)	$127,600

	Part B
James For 2016	
Taxable Capital Gains ($25,000 + $22,000)	$47,000
Recapture	73,000
Gwyneth For 2016	
Net Rental Loss	(7,400)
Gwyneth For 2017	
Taxable Capital Gain	15,000
Total	$127,600

TIF Solution Nine - 18

Tiffani

At Transfer

As Tiffani did not elect out of the ITA 73(1) spousal rollover, no income will result from the transfer to her spouse Hugh. However, there is no rollover for the transfer of public company shares to a related minor. This means there will be a taxable capital gain on the transfer of 14,000 shares to her son as follows:

Deemed Proceeds Of Disposition [($11)(14,000)]	$154,000
Adjusted Cost Base [($10)(14,000)]	(140,000)
Capital Gain	$ 14,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 7,000

Dividends

As all of the shares were given to a spouse and a related minor, 100 percent of the dividends would be attributed back to Tiffani. Her increase in Net Income For Tax Purposes due to the dividends would be $14,490 [(21,000)(138%)($0.50)].

Sale Of Shares

As there is no attribution of capital gains when shares are transferred to a related minor, the sale of shares by Tiffani's son would have no effect on her 2016 Net Income For Tax Purposes. However, the gain on the sale of shares by her spouse would be attributed back to Tiffani. The amount is calculated as follows:

Proceeds Of Disposition [($13)(7,000)]	$91,000
Adjusted Cost Base [($10)(7,000)]	(70,000)
Capital Gain	$21,000
Inclusion Rate	1/2
Taxable Capital Gain	$10,500

Hugh

None of these transactions would have any effect on Hugh's 2016 Income For Tax Purposes.

Mark

When Mark sells his shares, he will have a taxable capital gain calculated as follows:

Proceeds Of Disposition [($13)(14,000)]	$182,000
Adjusted Cost Base [($11)(14,000)]	(154,000)
Capital Gain	$ 28,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 14,000

If Tiffani Dies

Since Tiffani dies after the dividends are paid, but before Hugh sells his shares, the dividends will still be attributed back to Tiffani, but the taxable capital gain on the sale of Hugh's shares of $10,500 will be taxed in Hugh's hands.

The taxable capital gain on the sale of Mark's shares is already being taxed in Mark's hands, so there would be no change in tax effects for Mark if Tiffani were to die.

TIF Solution Nine - 19

Alonso

At Transfer

As Alonso did not elect out of the ITA 73(1) spousal rollover, no income will result from the transfer to his spouse Alice. However, there is no rollover for the transfer of public company shares to a related minor. This means there will be a taxable capital gain on the transfer of 10,000 shares to his son as follows:

Deemed Proceeds Of Disposition [($17.00)(10,000)]	$170,000
Adjusted Cost Base [($12.50)(10,000)]	(125,000)
Capital Gain	$ 45,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 22,500

Dividends

As all of the shares were given to a spouse and a related minor, 100 percent of the dividends would be attributed back to Alonso. His increase in Net Income For Tax Purposes due to the dividends would be $16,560 [(15,000)(138%)($0.80)].

Sale Of Shares

As there is no attribution of capital gains when shares are transferred to a related minor, the sale of shares by Alonso's son would have no effect on Alonso's 2016 Net Income For Tax Purposes. However, the gain on the sale of shares by his spouse would be attributed back to Alonso. The amount is calculated as follows:

Proceeds Of Disposition [($16.00)(5,000)]	$80,000
Adjusted Cost Base [($12.50)(5,000)]	(62,500)
Capital Gain	$17,500
Inclusion Rate	1/2
Taxable Capital Gain	$8,750

Alice

None of these transactions would have any effect on Alice's 2016 Income For Tax Purposes.

Alonso Jr.

When Alonso Jr. sells his Lisgar Inc. shares, he will have an allowable capital loss calculated as follows:

Proceeds Of Disposition [($16.00)(10,000)]	$160,000
Adjusted Cost Base [($17.00)(10,000)]	(170,000)
Capital Loss	($ 10,000)
Inclusion Rate	1/2
Allowable Capital Loss	($ 5,000)

This loss can only be deducted in 2016 to the extent that Alonso Jr. has taxable capital gains during 2016.

TIF Solution Nine - 20

Employment Income

While he is no longer an employee, the exercise of his former employer's stock option created employment income of $60,000 [(8,000)($22.50 - $15.00)]. As his former employer is a public company, the employment income benefit will be assessed in 2016 when the options are exercised.

Net Business Income

As Carlos is an accountant, he qualifies for the use of the billed basis of revenue recognition. This means that he does not have to accrue unbilled work in progress. Given this, the required calculations are as follows:

Income On Cash Flow Basis	$59,300
December 31 Billed Receivables	15,000
January 1 Billed Receivables	(37,000)
December 31 Accounts Payable	(32,000)
January 1 Accounts Payable	14,000
Accrual Based Income	$19,300
CCA On Building (Note 1)	(8,200)
CCA On Furniture And Fixtures (Note 1)	(8,280)
CCA On Automobile (Note 1)	(4,500)
Net Business Income (Loss)	($ 1,680)

Note 1 Mr. Santini's relocation of his business involves a voluntary disposition for a former business property. As the replacement occurred in the same year as the disposition, recapture is not an issue. However, in the absence of the ITA 44 election, there would be a capital gain on the sale of the building and land of $125,000, calculated as follows:

	Land	Building
Proceeds Of Disposition	$125,000	$300,000
Adjusted Cost Base	(100,000)	(200,000)
Capital Gain	$ 25,000	$100,000

As the problem requires determining minimum Net Income For Tax Purposes, we will assume that the ITA 44 election is made. This means that he will not have to recognize the $125,000 capital gain in 2016. However, the capital cost of the new building will be $280,000 and the adjusted cost base of the new land will be $115,000, calculated as follows:

	Land	Building
Actual Capital Cost	$140,000	$380,000
Capital Gain Deferred By Election	(25,000)	(100,000)
Adjusted Capital Cost	$115,000	$280,000

The January 1, 2017 adjusted cost base of the land is $115,000. The maximum 2016 CCA and January 1, 2017 UCC of Mr. Santini's business assets are as follows:

	Class 1	Class 8	Class 10.1
January 1, 2016 UCC	$165,000	$28,600	Nil
Additions (Notes 2 and 3)	280,000	58,000	$30,000
Disposals - Lesser Of:			
Cost	(200,000)		
Proceeds Of Disposition		(32,400)	
One-Half Net Additions	(40,000)	(12,800)	(15,000)
Base For CCA	$205,000	$41,400	$15,000
CCA At 4%, 20% and 30%	(8,200)	(8,280)	(4,500)
One-Half Net Additions	40,000	12,800	15,000
January 1, 2017 UCC	$236,800	$45,920	$25,500

Note 2 When a voluntary disposition is involved, the ITA 44 election only applies to real property and would not be applicable to the furniture and fixtures. However, this is not an issue in this problem as there is no capital gain on the disposition of the old furniture and fixtures. In addition, the assets are replaced in the year of disposition so there is no recapture of CCA.

Note 3 Although the capital cost of the automobile is $52,000, it is a Class 10.1 asset and eligible for CCA on only $30,000.

Property Income

Mr. Santini's property income can be calculated as follows:

Interest Income	$2,500
Eligible Dividends	3,820
Gross Up On Dividends [(38%)($3,820)]	1,452
Total Property Income	$7,772

Taxable Capital Gains

Mr. Santini's taxable capital gains would be calculated as follows:

Former Employer's Shares {[1/2][(8,000)($25.00 - $22.50) - $2,000]}	$ 9,000
Sale Of Toronto House (Note 4)	58,792
Sale Of Cottage (Note 4)	Nil
Taxable Capital Gains	$67,792

Note 4 For the 12 years 2005 through 2016, either the Toronto house or the Huntsville cottage could be designated as Mr. Santini's principal residence. The gain on the house is $141,100 ($420,000 - $273,900 - $5,000 for the required replacement of the heating system), while the gain on the cottage is $194,000 ($350,000 - $156,000). This would suggest that he should designate the cottage for 11 of the 12 years, with the remaining year going to the Toronto house. Using this allocation, the results are as follows:

	House	Cottage
Proceeds Of Disposition	$420,000	$350,000
Adjusted Cost Base ($273,900 + $5,000)	(278,900)	
		(156,000)
Commissions At 4.5% (Note 5)	N/A	(15,750)
Legal Fees	N/A	(675)
Capital Gain Before Exemptions	$141,100	$177,575
Exemptions:		
[$141,100][(1 + 1) ÷ 12]	(23,517)	
[$177,575][(11 + 1) ÷ 12]		(177,575)
Capital Gain	$117,583	Nil
Inclusion Rate	1/2	N/A
Taxable Capital Gain	$ 58,792	Nil

Note 5 The costs of selling a previously occupied residence that was ordinarily inhabited can be deducted as part of moving expenses. However, it cannot also be used to reduce the capital gain. As stated in the problem, Mr. Santini deducts the sales commission and legal fees on the house as a moving cost.

Other Income And Deductions

Mr. Santini's other income and deductions can be calculated as follows:

Spousal Support (Note 6)	$42,000
Moving Expenses (Note 7)	Nil
Universal Child Care Benefit (Note 8)	Nil
Child Care Costs (Note 9)	(24,000)
CPP Contributions On Self Employed Income (Note 10)	Nil
Total Other Income And Deductions	$18,000

Note 6 Of the $10,000 per month that Mr. Santini receives from his former spouse, $3,500 has been designated as spousal support. This $42,000 amount [(12)($3,500)] will be included in his Net Income For Tax Purposes. Neither the $6,500 per month in child support nor the $15,000 lump-sum payment will be included in Mr. Santini's Net Income For Tax Purposes.

Note 7 Mr. Santini has no income at the new work location and, as a consequence, he cannot deduct any moving expenses during 2016. However, he will have a significant carry forward, calculated as follows:

Real Estate Commissions On Toronto House [(4.5%)($420,000)]	$18,900
Legal Fees On Sale Of Toronto House	850
Legal Fees On Acquisition Of Kamloops House	940
Payments For Moving And Storage	9,800
Fee For Storage and Transport Of Minivan	1,500
Airfare To Kamloops	1,860
Costs Of In Kamloops While Waiting For New Residence	
Hotel (12 Nights At $300)	3,600
Food (12 Days, 4 People At $51 Flat Rate)	2,448
Total Moving Expenses Carried Forward	$39,898

Mr. Santini cannot deduct the costs of the Kamloops trip that was required to find a new residence.

Note 8 In a single parent family, the parent has the option of including the total amount of the benefits received in the income of a dependant who qualifies for the eligible dependant tax credit.

Since the problem requires the minimum Tax Payable and Carlos has income that is taxed at more than 15 percent, Carlos will not include the UCCB in his net income. The benefits will be considered income in the calculation of the eligible dependant credit.

Note 9 The deductible amount of child care cost is based on the least of three figures:

- **Actual Child Care Costs Plus Deductible Camp Costs** During the 4 week period when they are at camp, their costs are limited to $275 per week for Lolita and $125 per week for Estelle. The total is as follows:

Actual Child Care Costs Other Than Camp ($22,500 + $1,000)	$23,500
Deductible Camp Costs - 4 Weeks At $400 ($275 + $125)	1,600
Total Actual Child Care Costs Allowed	$25,100

- **Annual Limit** The annual limit is $24,000 ($8,000 for Andrew, $11,000 for Lolita, and $5,000 for Estelle).

- **Income Limit** For this purpose, Mr. Santini's "earned income" is his gross employment income of $60,000. Two-thirds of this would be $40,000. His business loss of $1,680 does not affect this limit as it was a loss.

The least of these figures is the annual limit of $24,000.

Note 10 Carlos has a net business loss and his former employer withheld the maximum CPP contributions. Either of these facts would be sufficient reason that he has no CPP payable on his self-employed income.

Net Income For Tax Purposes

Mr. Santini's Net Income For Tax Purposes would be determined as follows:

Employment Income	$ 60,000
Net Business Income (Loss)	(1,680)
Property Income	7,772
Taxable Capital Gains	67,792
Other Income And Deductions	18,000
Net Income For Tax Purposes	$151,884

The contributions made by Carlos to the TFSAs, RESP and RDSP are not deductible in determining his Net Income For Tax Purposes. In addition, the withdrawal from his TFSA is not taxable.

Taxable Income

Mr. Santini's Taxable Income would be determined as follows:

Net Income For Tax Purposes	$151,884
Stock Option Deduction [(1/2)($60,000)]	(30,000)
Taxable Income	$121,884

Tax Payable

Mr. Santini's Tax Payable would be determined as follows:

Tax On First $90,563		$16,075
Tax On Next $31,321 ($121,884 - $90,563) At 26 Percent		8,143
Tax Before Credits		$24,218
Tax Credits:		
Basic Personal	($11,474)	
Eligible Dependant - Andrew ($11,474 - $1,320) (Note 8 and 10)	(10,154)	
Family Caregiver Amount - Lolita	(2,121)	
Caregiver Including FCA - Estelle (Note 11)	(6,788)	
Transfer Of Lolita's Disability	(8,001)	
Lolita's Disability Supplement (Note 12)	Nil	
CPP (Maximum)	(2,544)	
Canada Employment	(1,161)	
Medical Expenses (Note 13)	(18,683)	
Total Credit Base	($60,926)	
Rate	15%	(9,139)
Charitable Contributions (Note 14)		(668)
Dividend Tax Credit [(6/11)($1,452)]		(792)
CPP Contributions (Note 10)		Nil
Federal Tax Payable		$13,619

Note 11 As the eligible dependant credit has been claimed using Andrew, Estelle is not eligible for this credit. This means that she is eligible for both the caregiver credit and the infirm dependant over 17 credit. When this is the case, ITA 118(4)(d) deems the individual not to be a dependant, thereby requiring the use of the caregiver credit. Because Estelle is infirm, and has no income, Carlos can claim the full amount of the caregiver credit, as well as the family caregiver amount.

Note 12 The disability supplement of $4,667 is not available as it has to be reduced for child care costs in excess of $2,734. As it would be reasonable to allocate $7,500 [(1/3)($22,500)] of the child care costs to Lolita, this would be in excess of $7,401 [($4,667 + $2,734)].

Note 13 The medical expenses eligible for the credit are as follows:

Medical Expenses Of Carlos, Andrew, And Lolita ($850 + $1,250 + $8,560)		$10,660
Lesser Of:		
• [(3%)($151,884)] = $4,557		
• 2016 Threshold Amount = $2,237		(2,237)
Balance Before Dependants 18 And Over		$ 8,423
Estelle's Medical Expenses	$10,260	
Reduced By The Lesser Of:		
• $2,237		
• [(3%)(Nil)] = Nil	Nil	10,260
Medical Expense Tax Credit Base		$18,683

Note 14 As Carlos' Taxable Income is less than $200,000, the 33 percent rate is not relevant to the calculation of his charitable donations tax credit. Given this, the credit is equal to $668 [(15%)($200) + (29%)($2,400 - $200)].

Chapter Ten Test Item File Solutions

TIF Solution Ten - 1

1. The major advantages can be described as follows:
   - Eligible contributions are fully deductible and provide an immediate reduction in Tax Payable.
   - While the contributions are invested in the plan, earnings on the investments accumulate on a tax free basis. (This would not provide any advantage with respect to contributions made to a defined benefit RPP.)
   - When the funds are withdrawn from the plan, the individual may be in a lower tax bracket than he was in when he made the contributions. When this is the case, there is tax avoidance in that the taxes saved on the deduction are greater than the taxes paid on the withdrawal.
   - The payments from an RPP or RRSP may be eligible for both the pension income tax credit and for pension income splitting.
   - An additional advantage for RRSPs only is that funds can be temporarily withdrawn on a tax free basis using the home buyers plan or the lifelong learning plan.

2. With respect to the first statement, making contributions to an RRSP results in deferral as the contributions are deductible when made, but will only be taxed when withdrawn. As the withdrawal will usually be in a later taxation year, the payment of taxes is deferred from the year of contribution to the year of withdrawal.

   In some cases, an individual may be subject to the same tax rate in the year of withdrawal as was applicable in the year of contribution. However, if the tax rate is lower, either because of the individual's income level or because applicable rates have changed, the amount of tax on withdrawal will be less than the amount saved at the time of contribution. This results in actual tax avoidance.

3. The reason tax advisors make these recommendations is to extend the period of tax free compounding. A payment made on January 1 will benefit from a full extra year of tax free compounding, as compared to a payment made on December 31 of that year.

4. In defined benefit plans, the plan sponsor undertakes to provide a specified benefit, usually expressed as a percentage of earnings, for each year of qualifying service. In promising this benefit, the employer has effectively agreed to make whatever amount of contributions is required to provide these benefits.

   In contrast, in a money purchase plan, the employer agrees to make specified contributions for each plan participant. In this case, the employer has no responsibility beyond making the required contributions. The benefit that will be received by the employee will be based on the amounts of funds that are accumulated in the plan.

5. Such a contribution would not be a good idea. ITA 40(2)(g)(iv) does not allow the recognition of a loss when an individual transfers assets into an RRSP. This means the loss would never be available to the individual. If the individual is short of cash, the better alternative would be to sell the shares and use the proceeds to make the RRSP contribution. Using this approach, the loss would be available to apply against any capital gains that may accrue to the individual.

6. The income earned by equity securities consists of dividends and capital gains, both of which receive tax treatment that, when earned outside an RRSP, is more favourable than that given to interest on debt securities. Specifically, only one-half of capital gains are subject to tax while, in the case of both eligible and non-eligible dividends, the gross up and tax credit procedure serves to significantly reduce the rate applicable to this type of income. In contrast, when accumulated dividends or capital gains are removed from an RRSP, the amounts are taxable at full personal rates, thereby eliminating any tax advantages associated with capital gains or dividends. For this reason, it makes sense to keep equity holdings outside of an RRSP and to allocate interest bearing debt securities to the RRSP.

7. The RRSP Deduction Limit, as the name implies, is a limit on the amount of contributions that can be deducted in a particular year. However, a limited amount of non-deductible contributions, that are in excess of the RRSP Deduction Limit, can be made without attracting a penalty. Further, contributions made in earlier years that were not deducted in those years, or contributions made in the first 60 days of the following year, can be deducted under the RRSP Deduction Limit for the current year.

8. The components of Earned Income for purposes of determining the RRSP Deduction Limit are as follows:

    - Employment income computed without the deduction of RPP contributions.
    - Royalties, provided the taxpayer is the author, inventor, or composer.
    - Taxable (deductible) support payments.
    - Supplementary unemployment benefits.
    - Business income (loss).
    - Income (loss) earned as an active partner.
    - Net rental income (loss).
    - CPP disability benefits.

9. In simplified terms, benefits earned in defined benefit plans are converted to a contribution-like number by multiplying the benefits earned by an individual by the number 9. The use of this approach does not take into consideration the fact that it would take a much larger contribution to provide $1 of benefits to a 64 year old individual who will retire in one year, than it would to provide $1 of benefits to a 20 year old individual who will not receive the benefit for 45 years. This would suggest that the approach used is systematically unfair to younger taxpayers.

10. The situations that are described in the text are as follows:

    - A new RPP is implemented by an employer and benefits are extended retroactively for years of service prior to the plan initiation.
    - The benefit formula is changed, increasing the percentage that is applied to pensionable earnings to determine benefits earned. Again, a PSPA is created only if the increased benefits are extended retroactively to years of service prior to the plan amendment.
    - An individual, either voluntarily or because of terms contained in the plan, works for a number of years without being a member of the plan. On joining the plan, the employee is credited for years of service prior to entry into the plan.

11. Pension adjustment reversals arise when an individual earns non-vested benefits for which PAs have been issued. If the non-vested benefits are lost, most commonly through leaving the service of the employer granting the benefits, the employer must report a pension adjustment reversal to add the previously deducted PAs back to the individual's RRSP deduction room.

12. With respect to contributions, amounts contributed to an RRSP are deductible, while similar contributions to a TFSA cannot be deducted. With respect to earnings on assets held within the plan, both types of plans feature tax free accumulation of these earnings.

    However, withdrawals are treated differently by the two types of plans. In general, amounts withdrawn from an RRSP are subject to tax at full individual rates. No consideration is given to the type of income that formed the basis for the withdrawals. In contrast, withdrawals from a TFSA are not subject to tax.

    A further difference between the two types of plans is that, in general, amounts withdrawn from an RRSP cannot be returned. This means that withdrawals represent a permanent reduction in an individual's RRSP deduction room. In contrast, amounts withdrawn from a TFSA can be returned to the plan in the following year. Such returned amounts serve to restore the contribution room that was removed by earlier withdrawals.

13. There are several points to be made here:

    - Contributions that are more than $2,000 greater than the individual's unused deduction room should not be made as they attract a penalty of 1 percent per month.
    - Non-deductible contributions of $2,000 or less have the advantage of having the earnings resulting from their investment accumulate on a tax free basis.
    - The basic point for your friend, however, is that while he cannot deduct contributions in excess of his unused deduction room at the time the contributions are made, he can deduct them in any future period when deduction room becomes available. As a consequence, his basic point is only valid if the excess contributions are never deducted.

14. The disadvantages can be described as follows:

    - Such withdrawals can subject a large amount of income to the highest marginal tax rates.
    - Such withdrawals are not eligible for the pension income tax credit.
    - Such withdrawals are not eligible for pension income splitting.

    While it probably would not be considered a disadvantage, we would note that withdrawals of $5,001 or more are subject to withholding.

15. When an individual reaches age 71, his RRSP must be collapsed. The basic alternatives for withdrawing the funds in the plan, along with the related tax consequences, are as follows:

    - The total amount of assets in the plan can simply be withdrawn. This alternative will result in the fair market value of all of the assets being included in the individual's income in the year of withdrawal.
    - The assets in the plan can be converted to cash and the proceeds used to purchase an annuity. There will be no immediate consequences associated with the purchase of the annuity. However, the subsequent payments will be included in full in the taxpayer's income as they are received.
    - The assets in the RRSP can be transferred to a RRIF. There are no tax consequences associated with this rollover. However, the taxpayer will have to make a minimum withdrawal from the RRIF in each subsequent year. The full amount of each withdrawal will be taxed in the year that it is received.

    These are not mutually exclusive choices. They can be used in combinations (e.g., one-half the funds to a RRIF, with the remaining one-half being used to purchase an annuity).

16. Contributions to a spousal plan are desirable when the individual's spouse or common-law partner is currently in a lower tax bracket and is expected to remain in a lower bracket. There are two advantages to making such contributions:

    - Income splitting. When the contributions are withdrawn they will be taxed at the spouse or common-law partner's lower tax rate.

    - In situations where the spouse or common-law partner has no other source of pension income, withdrawals from the spousal plan could be eligible for the pension income tax credit.

    Note that although these results could also be achieved through the use of the provisions which allow for the splitting of qualified pension income, a spousal RRSP provides the couple with more flexibility in planning retirement income.

17. If an individual has made any contribution to an RRSP that has his spouse or common-law partner as the registrant, it is a spousal RRSP. With respect to such plans, if a contribution is made, either in the year of a withdrawal or in either of the two preceding calendar years, that withdrawal must be included in the contributor's income to the extent of the spousal contributions made in the year of the withdrawal or in either of the two preceding calendar years.

18. The basic factors to consider would be as follows:

    - Whether the required funds could be acquired through a conventional mortgage.
    - What rate would be paid on conventional mortgage financing.
    - What rate is being earned on the investments in the plan.
    - The fact that the earnings lost while the funds are out of the plan can never be put back in the plan, resulting in a permanent loss of tax assisted savings.

19. The basic factors to consider would be as follows:

    - Alternative sources of financing.
    - The financing rate on alternative sources of financing.
    - The rates of return on assets that are in the RRSP.
    - The fact that the earnings lost while the funds are out of the plan can never be put back in the plan, resulting in a permanent loss of tax assisted savings.

20. The general rule here is that the fair market value of the assets in the unmatured plan will be included as income in the decedent's final tax return. However, there are two exceptions to this general rule:

    - If the beneficiary of the RRSP is the decedent's spouse, there is a rollover provision that allows the transfer of the balances in the plan to a spouse or common-law partner without tax consequences. In effect, the spouse becomes the new registrant of the plan and there are no tax consequences for the decedent.

    - If the beneficiary of the RRSP is a financially dependent child or grandchild, the assets will be taxed as income to that dependent. In addition, if the child or grandchild has a physical or mental infirmity, the dependant can avoid current taxation by transferring the assets to an RRSP, RRIF, RDSP, or using them to purchase an annuity.

21. There are two classes of potential members. One class would be employees of an employer that offers participation in a PRPP. The second class of members would include employees of an employer that does not offer a PRPP, as well as self-employed individuals.

22. The basic differences are as follows:

    - RRIFs are only funded through a transfer from an RRSP or another RRIF. In contrast, the individual can make deductible contributions or transfer funds from another retirement savings plan (RRSP, RPP, DPSP) in order to get funds into an RRSP.
    - There is no requirement to make minimum annual withdrawals from an RRSP. In contrast, an individual must make a minimum withdrawal each year from a RRIF.
    - An individual can have a RRIF after the age of 71. They cannot have an RRSP after that age.
    - RRIFs are not eligible for withdrawals under either the home buyers plan or the lifelong learning plan.

23. DPSPs provide tax deferral in that employer contributions to these plans do not create a taxable benefit until they are withdrawn from the plan. There is further deferral in the fact that amounts earned on the DPSP investments accumulate tax free, with these amounts also not being taxed until they are withdrawn from the plan. In contrast, employer contributions to a PSP are treated as taxable benefits to the employees who receive them. In addition, amounts earned on the PSP's assets are taxed in the hands of the employees as they are earned. While there may be human resource or motivational reasons for using PSPs, the use of these plans does not provide any tax advantages to employees.

24. An employer's contributions to a retirement compensation arrangement (RCA) are fully deductible in computing Taxable Income. However, all contributions are subject to a Part XI.3 refundable tax at a rate of 50 percent. In addition, all of the earnings on the assets that are in the plan are subject to this same 50 percent tax. The Part XI.3 taxes that the employer pays are refunded at a 50 percent rate when payments are made to the beneficiaries of the plan. The recipients will be subject to income tax at relevant rates when the benefits are paid.

25. As defined in ITA 248(1), a salary deferral arrangement is a plan or arrangement, whether funded or not, under which any person has a right to receive an amount in a year subsequent to the year in which it was earned. The definition also requires that one of the main purposes of the arrangement is defer Tax Payable. The definition goes on to exclude such items as RPPs, sabbatical arrangements, and bonuses that are paid within three calendar years.

TIF Solution Ten - 2

1. True. In general, deferral is available as individuals can deduct contributions when they are made, are not taxed on amounts earned within the plan, and only pay taxes when amounts are withdrawn from the plan. Avoidance may also be available if the individual is in a lower tax bracket when taxable withdrawals are made than he was when the deductible contributions were made.

2. True. A pension plan that provides for a pension equal to 3 percent of an employee's average annual salary for each year of service is a defined benefit plan.

3. True. All of these items are components of Earned Income for RRSP purposes.

4. False. Only those undeductible contributions in excess of $2,000 are subject to the penalty.

5. True. Once a spouse or common-law partner has made a contribution, the plan is permanently designated a spousal RRSP.

6. True. The amounts must be repaid over 15 years, beginning in the second calendar year after withdrawal.

7. False. While the tax free withdrawal is conditional on being enrolled in a qualified educational program at a designated educational institution, there is no requirement that the funds be used for any particular purpose.

8. False. The employees' contributions have no effect on the deductibility of the employer's contributions. A maximum of $25,000 is deductible.

9. False. Contributions to DPSPs are not considered to be taxable benefits to employees.

10. False. The tax free transfer is limited to $2,000 per year of service with the employer prior to 1996, plus an additional $1,500 for each year of service prior to 1989 for which the employer's contributions to an RPP or a DPSP had not become vested at the time the retiring allowance is granted.

TIF Solution Ten - 3

New For 2016/2017

1. D. Past Service Pension Adjustments can only arise when the plan is a defined benefit plan.

2.j C. If an individual has terminated his RRSP because he has turned 71, he can no longer make RRSP contributions, even if he has Earned Income. Such an individual can continue making contributions to a spousal RRSP.

3. C. Repayments in excess of an annual requirement will reduce future annual requirements. While the applicable fraction will not change, the balance to which the fraction will apply will be reduced.

4. B. An individual can only participate in this program once during his life. There is no limit on the number of times, as long as all previous withdrawals have been repaid.

5. B. Employee contributions provide the contributor with credit against tax payable.

6. A. Withdrawals from a RIFF are not eligible for pension income splitting.

7. B. Contributions to DPSPs are limited to one-half the money purchase limit for the year.

8. D. Withdrawals from the plan are received tax free by employee.

9. B. Contributions to RCAs are subject to a 50 percent, non-refundable tax.

Retained From Previous Editions

10. B. The employer promises each employee a retirement benefit that is based on a contractually specified formula.

11. D. The employee's pension benefit is not affected by rates of return on the pension plan assets.

12. C. Direct investments in rental properties.

13. B. $580 [(18%)($40,000 - $16,000 + $7,000) - ($2,000 + $3,000)]

14. D. $2,580 [(18%)($40,000 - $16,000 + $7,000) - $3,000].

15. B. $5,580 [(18%)($40,000 - $16,000 + $7,000)].

16. A. $3,580 [(18%)($40,000 - $16,000 + $7,000) - $2,000].

17. D. $12,360.

Unused RRSP Deduction Room carried forward from 2015:	
Lesser Of:	
• ($24,930 - $6,000) = $18,930*	
• [(18%)($50,000) - $6,000] = $3,000	$ 3,000
Plus 2016 RRSP deduction room	
Lesser Of:	
• 2016 RRSP Dollar Limit = $25,370	
• [(18%)($52,000)] = $9,360	9,360
RRSP Deduction Limit	$12,360

* Previous year's RRSP dollar limit is not needed as $3,000 is obviously the lesser number.

18. A. Resource royalties, CPP retirement benefits and scholarships do not form part of the Earned Income calculation for RRSP purposes.

19. D. Contributions made during the current year can be deducted in any subsequent year.

20. D. Mrs. Wu's 2016 taxable income increased by $600 and Mr. Wu's increased by $1,000.

21. A. She will receive cash of $8,000 and her 2016 taxable income will increase by $10,000. $10,000 less 20% withholding tax = $8,000.

22. D. His taxable income will be increased by $2,000.

23. B. $43,000

24. A. All amounts withdrawn must be repaid within 10 years of the year of withdrawal.

25. C. $1,600.00 ($24,000 – 1,000 pmt – 600 included in 2016 taxable income) = $22,400 x 1/14 = $1,600

26. B. An increase of $300. (min. repayment of $1,000 – 700)

27. C. Minimum repayments must be made over a period of ten years.

28. D. March 1, 2018. Since 2017 is the fifth year after the first withdrawal, she has 60 days after the year end to make the repayment.

29. A. Eileen can deduct her contribution from her Net Income For Tax Purposes and her employer's contribution is not considered a taxable benefit.

30. A. Contributions can be made only by employers.

31. C. Earnings accumulate within the RRIF on a tax free basis.

32. A. $12,400 ($62,000 x 20%)

33. A. He wants to split his RRIF withdrawal with his wife.

34. C. Profit Sharing Plan to Deferred Profit Sharing Plan.

35. D. the individual reaches age 71

36. C. The amount of the retiring allowance which Mr. Smith can transfer to his RRSP in the year he retires is $59,500 [(20)($2,000) + (13)($1,500)]. This is $2,000 per year prior to 1996, plus $1,500 per year prior to 1989 during which no employer contributions vested to a pension plan.

37. B. a lump sum withdrawal from a RRIF

38. B. Income earned within the plan is accumulated on a tax-free basis.

TIF Solution Ten - 4

Exam Exercise Solution Ten - 1 (Dividends Earned In An RRSP)

Alternative 1 - As the $50,000 is from an inheritance, this Exam Exercise differs from the example in the text and from the Exercise that is included in the text. In those examples, the available funds involved pre-tax income, resulting in a need to pay taxes on the funds prior to making an investment outside of an RRSP. In this example, no payment of taxes is required prior to investment and the full $50,000 can be used to acquire preferred shares. Given this, the results are as follows:

Dividends Received [(5.5%)($50,000)(5)]	$13,750
Taxes [(26%)($13,750)]	(3,575)
After Tax Income	$10,175
Principal Amount	50,000
Available Funds For Home Purchase	$60,175

Alternative 2 - Again, because we are dealing with a tax-free inheritance, rather than pre-tax income, the calculations for this alternative are different. Specifically, we have to take into consideration the $21,500 [([(43%)($50,000)], tax savings that will be created by the RRSP deduction. Assuming that he invests these savings outside the RRSP in the preferred shares, he would have the following amount available for his home purchase after 5 years:

Dividends Received [(5.5%)($21,500)(5)]	$ 5,913
Taxes [(26%)(5,913)]	(1,537)
After Tax Income	$ 4,376
Principal Amount	21,500
Available Funds For Home Purchase	$25,876

The additional amount of funds after withdrawing the total amount of funds that have accumulated in the RRSP and paying taxes on this amount would be calculated as follows:

Dividends Received In The RRSP [(5.5%)($50,000)(5)]	$13,750
Contribution Withdrawn	50,000
Total Withdrawal	$63,750
Taxes [(43%)($63,750)]	(27,413)
Available Funds For Home Purchase	$36,337

When this $36,337 amount is combined with the $25,876 from the non-RRSP investment, the total is $62,213. This is $2,038 better than the $60,175 that was available when the $50,000 was invested outside the RRSP.

Exam Exercise Solution Ten - 2 (Earned Income)

His Earned Income for RRSP purposes will be $61,550 ($78,300 + $2,400 - $6,750 - $12,400).

Exam Exercise Solution Ten - 3 (Earned Income)

Her Earned Income for RRSP purposes will be $67,700 ($56,200 + $1,800 - $2,300 + $12,000).

Exam Exercise Solution Ten - 4 (Pension Adjustments)

The Pension Adjustment will be $6,900 ($2,600 + $1,700 + $2,600).

Exam Exercise Solution Ten - 5 (Pension Adjustments)

The Pension Adjustment will be $6,250 ($2,500 + $1,250 + $2,500).

Exam Exercise Solution Ten - 6 (Unused RRSP Deduction Room)

The required calculation would be as follows:

Unused Deduction Room - End Of 2015	$5,100
Lesser Of:	
• 2016 RRSP Dollar Limit = $25,370	
• 18% Of 2015 Earned Income Of $43,500 = $7,830	7,830
Less 2016 Deduction	(5,200)
Unused RRSP Deduction Room - End Of 2016	$7,730

Mrs. Lair has undeducted contributions of $1,800 ($7,000 - $5,200) that can be carried forward and deducted in any subsequent year as there is already sufficient RRSP deduction room.

Exam Exercise Solution Ten - 7 (Unused RRSP Deduction Room)

The required calculation would be as follows:

Unused Deduction Room - End Of 2015	$6,500
Lesser Of:	
• 2016 RRSP Dollar Limit = $25,370	
• 18% Of 2015 Earned Income Of $96,000 = $17,280	17,280
Less 2016 Deduction	(8,500)
Unused RRSP Deduction Room - End Of 2016	$15,280

Mr. Flack has undeducted contributions of $500 ($9,000 - $8,500) that can be carried forward and deducted in any subsequent year as there is already sufficient RRSP deduction room.

Exam Exercise Solution Ten - 8 (Maximum RRSP Deduction)

The required calculations would be as follows:

Net Employment Income	$80,200
RPP Contributions	3,000
Net Rental Income	5,720
Spousal Support Deducted	(15,000)
2015 Earned Income	$73,920

Unused Deduction Room - End Of 2015	$11,120
Lesser Of:	
• 2016 RRSP Dollar Limit = $25,370	
• 18% Of 2015 Earned Income Of $73,920 = $13,306	13,306
Less 2015 PA	(6,000)
2016 RRSP Deduction Limit	$18,426
RRSP Deduction Is Lesser Of:	
• RRSP Deduction Limit = $18,426	
• Available Contributions = $19,275 ($6,275 + $13,000)	(18,426)
Unused RRSP Deduction Room - End Of 2016	Nil

Mrs. White has undeducted contributions of $849 ($19,275 - $18,426) that can be carried forward and deducted in a subsequent year in which there is sufficient RRSP deduction room.

Exam Exercise Solution Ten - 9 (Maximum RRSP Deduction)

The required calculations would be as follows:

Net Employment Income	$45,000
RPP Contributions	1,800
Spousal Support Received	18,000
Business Loss	(3,500)
2015 Earned Income	$61,300

Unused Deduction Room - End Of 2015	$ 4,800
Lesser Of:	
• 2016 RRSP Dollar Limit = $25,370	
• 18% Of 2015 Earned Income Of $61,300 = $11,034	11,034
Less 2015 PA	(3,600)
2016 RRSP Deduction Limit	$12,234
RRSP Deduction Is Lesser Of:	
• RRSP Deduction Limit = $12,234	
• Available Contributions = $13,200 ($3,800 + $9,400)	(12,234)
Unused RRSP Deduction Room - End Of 2016	Nil

Ms. Blue has undeducted contributions of $966 ($13,200 - $12,234) that can be carried forward and deducted in a subsequent year in which there is sufficient RRSP deduction room.

Exam Exercise Solution Ten - 10 (Excess RRSP Contributions)

The required calculations are as follows:

2015 Contribution	$13,500
2015 Addition To Deduction Room [(18%)($75,000)]	(13,500)
Excess Contribution	Nil

2016 Contribution	$16,000
$2,000 Cushion	(2,000)
2016 Addition To Deduction Room [(18%)($75,000)]	(13,500)
Excess Contribution Subject To Penalty	$ 500

As the $16,000 contribution was made on May 1, 2016, there will be a 2016 penalty of $40 [(1%)($500)(8)]. The fact that there is no RRSP deduction is not relevant to the penalty.

Exam Exercise Solution Ten - 11 (Excess RRSP Contributions)

The required calculations are as follows:

2015 Contribution	$18,900
2015 Addition To Deduction Room [(18%)($105,000)]	(18,900)
Excess Contributions	Nil

2016 Contribution	$22,000
$2,000 Cushion	(2,000)
2016 Addition To Deduction Room [(18%)($105,000)]	(18,900)
Excess Contribution Subject To Penalty	$ 1,100

As the $22,000 contribution was made on April 1, 2016, there will be a 2016 penalty of $99 [(1%)($1,100)(9)]. The fact that there is no RRSP deduction is not relevant to the penalty.

Exam Exercise Solution Ten - 12 (Spousal RRSP Withdrawal)

The wife's plan is a spousal plan as contributions to the plan have been made by Mr. Peters. Given this, when the 2016 withdrawal is made, any contributions made by Mr. Peters in 2016, or the two preceding years are attributed to him. This means that $3,500 ($1,500 + $2,000) of the 2016 withdrawal will be attributed to him. The remaining $800 ($4,300 - $3,500) will be taxed in the hands of his wife.

Exam Exercise Solution Ten - 13 (Spousal RRSP Withdrawal)

The wife's plan is a spousal plan as contributions to the plan have been made by Mr. Bryant. Given this, when the 2016 withdrawal is made, any contributions made by Mr. Bryant in 2016, or the two preceding years are attributed to him. This means that $10,000 ($4,500 + $5,500) of the 2016 withdrawal will be attributed to him. The remaining $1,000 ($11,000 - $10,000) will be taxed in the hands of his wife.

Exam Exercise Solution Ten - 14 (Home Buyers' Plan)

Mr. Debon's minimum payment for 2015 would be $433 [(1/15)($15,000 - $8,500)]. Note that the voluntary payment that was made during 2014 did not reduce the fraction of the remaining balance that must be repaid in 2015. If he does not make this payment, the amount will be added to his 2015 Net Income For Tax Purposes and subtracted from his HBP balance. Without regard to whether or not he makes this $433 payment, his minimum payment for 2016 would again be $433 [(1/14)($15,000 - $8,500 - $433)].

Exam Exercise Solution Ten - 15 (Home Buyers' Plan)

Mr. Borshiov's minimum payment for 2015 would be $933 [(1/15)($21,000 - $7,000)]. Note that the voluntary payment made in 2014 did not reduce the fraction of the remaining balance that must be repaid in 2015. If no payment is made in 2015, the $933 will be added to his Net Income For Tax Purposes and subtracted from his HBP balance. Whether or not he makes the 2015 payment, the minimum payment for 2016 would again be $933 [(1/14)($21,000 - $7,000 - $933)].

Exam Exercise Solution Ten - 16 (Lifelong Learning Plan)

As the withdrawals are within the annual limit of $10,000 and the overall limit of $20,000, there will be no tax consequences associated with the withdrawals from Mr. Forsyth's RRSP.

The repayment period will begin in 2016, as this is the fifth year (the maximum delay) of his participation in the Lifelong Learning Plan. It did not begin earlier because he had at least three months of education tax credits in the years 2011 through 2015.

There are no tax consequences in 2016, as his designated repayment of $2,900 exceeds the required amount of $2,000 ($20,000 ÷ 10).

The required repayment for 2017 is $1,900 [($20,000 - $2,900) ÷ 9]. The shortfall in his payment of $400 ($1,900 - $1,500) will be included in his income for 2017. This illustrates the fact that excess payments in some years cannot be applied against shortfalls in subsequent years.

Exam Exercise Solution Ten - 17 (Lifelong Learning Plan)

As the withdrawals are within the annual limit of $10,000 and the overall limit of $20,000, there will be no tax consequences associated with the $18,000 [(3)($6,000)] of withdrawals from Mr. Botterill's RRSP.

The required repayment period begins in 2016, the fifth year of his participation in the Lifelong Learning Plan. This is the maximum delay unless the individual goes for two years without being eligible for 3 months of the full time education credit. This is not the case with Mr. Botterill.

There are no tax consequences in 2016 as Mr. Botterill's designated payment of $2,200 exceeds the required minimum of $1,800 ($18,000 ÷ 10).

The required payment in 2017 is $1,756 [($18,000 - $2,200) ÷ 9]. The shortfall of $556 ($1,756 - $1,200) will be included in his 2017 Net Income For Tax Purposes.

Exam Exercise Solution Ten - 18 (Minimum RRIF Withdrawal)

There is no required withdrawal from the RRIF in 2016, as this is the year that it is established. For 2017, the minimum withdrawal is $61,364 [$1,350,000 ÷ (90 - 68)].

Exam Exercise Solution Ten - 19 (Minimum RRIF Withdrawal)

In the year a RRIF is established, there is no minimum withdrawal. This means that there is no required minimum withdrawal for 2016. For 2017, the minimum would be $130,000 [$2,600,000 ÷ (90 - 70)].

Exam Exercise Solution Ten - 20 (Retiring Allowance)

If Mrs. Barth has worked for 33 years as of 2016, she must have started in 1984. Given this, she can rollover a total of $31,500 [($2,000)(12 Years Before 1996) + ($1,500)(5 Years Before 1989)]. The remaining $53,500 ($85,000 - $31,500) will be subject to tax in 2016.

Exam Exercise Solution Ten - 21 (Retiring Allowance)

If Ms. Jones has worked for 35 years as of 2016, she must have started in 1982. Given this, she can rollover a total of $38,500 [($2,000)(14 Years Before 1996) + ($1,500)(7 Years Before 1989)]. The remaining $23,500 ($62,000 - $38,500) will be subject to tax in 2016.

TIF Solution Ten - 5A

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

A. 10

B. 9

C. 7

D. 8

E. 5

F. 3

G. 1

H. 4

The two unused definitions are as follows:

Registered Pension Plan = 2

Registered Retirement Savings Plan = 6

TIF Solution Ten - 5B

For some terms there is both a 100 percent correct answer and an answer that is close. We have indicated the “close answer” in brackets.

The correct definitions for each of the listed key terms listed below.

A. 13

B. 12 (not 3)

C. 9 (not 10)

D. 11 (not 14)

E. 6

F. 4 (not 7)

G. 1

H. 5

The two unused definitions are as follows:

Registered Pension Plan = 2

Registered Retirement Savings Plan = 8

TIF Solution Ten - 6

Case 1

The required 2016 PA would be calculated as follows:

Employer's Contribution To DPSP	$2,500
Employer's Contribution To RPP	1,000
Fredia's Contribution To RPP	1,000
PA	$4,500

Case 2

The required 2016 PA would be calculated as follows:

[(1.25%)(9)($71,000)] = $7,988

Note that the contributions made during 2016 have no influence on the PA for a defined benefit RPP.

Case 3

The required PSPA would be calculated as follows:

2014 Amount [(1.1%)(9)($38,000)]	$3,762
2015 Amount [(1.1%)(9)($42,000)]	4,158
2016 PSPA	$7,920

In addition to the PSPA calculated above, there would be a 2016 PA of $5,049 [(1.1%)(9)($51,000)].

Case 4

The required PAR would be calculated as follows:

2014 PA	$ 5,200
2015 PA	5,400
2016 PAR	$10,600

Case 5

The required PSPA would be calculated as follows:

2014 Amount [(1.5% - 1.3%)(9)($58,000)]	$1,044
2015 Amount [(1.5% - 1.3%)(9)($62,000)]	1,116
2016 PSPA	$2,160

There would also be a 2016 PA. However, this cannot be calculated as the problem does not provide the 2016 pensionable earnings.

TIF Solution Ten - 7

Part A - Maximum RRSP Deduction

Deeta's maximum 2016 RRSP deduction would be calculated as follows:

Unused Deduction Room - January 1, 2015	$35,000
2015 Addition	Nil
2016 Addition (Based On 2015 Earned Income Of Nil)	Nil
Maximum 2016 RRSP Deduction	$35,000

Part B - Excess RRSP Contributions

At the beginning of 2015, Deeta's undeducted contributions of $37,000 are equal to her $35,000 unused deduction room, plus the permitted $2,000 cushion. As she withdraws $25,000 and made no further contributions during 2015, there are no excess contributions during the 2015 taxation year.

The excess contributions for 2016 would be calculated as follows:

Undeducted Contributions	
January 1, 2016 ($37,000 - $25,000)	$12,000
Additional Contribution On May 2, 2016	40,000
Total Undeducted Contributions	$52,000
Unused Deduction Room	(35,000)
Permitted Cushion	(2,000)
Excess Contributions Subject To Penalty	$15,000
Penalty Rate	1%
Monthly Penalty	$ 150
Months (May To December)	8
Total Penalty	$ 1,200

Part C - Advice On Tax Planning

As the preceding calculation demonstrates, Deeta's excess contributions are attracting a significant penalty, based on a monthly charge of 1 percent of the excess amount.

Since her earned income for 2016 will only be $61,000, she will still have excess contributions of $4,020 [$15,000 - ($61,000)(18%)] for 2017. If the excess contributions are withdrawn from the RRSP prior to the end of the year following the year in which an assessment is received for the year in which the contribution is made, an offsetting deduction is available. If, however, any excess is not withdrawn within this specified time frame, it will be included in income and taxed on withdrawal, even though it was never deducted from income.

Deeta should withdraw the $4,020 immediately to stop the assessment of the penalty.

Since she has never had a TFSA, she should open one. The withdrawn funds should be contributed to her TFSA, along with any other excess funds up to her TFSA contribution room. For 2016, the maximum total contributions are $46,500 and, while TFSA contributions are not deductible, earnings accumulate on a tax free basis. In addition, withdrawals can be made without tax consequences.

Whether Deeta should withdraw the $2,000 cushion as well depends on future expectations. As there is no time limit on using contributions that are in the plan, it would make sense to simply leave the $2,000 in place, provided that she expects to have earned income in some future year.

In the future, she should ensure that she continues to contribute to her RRSP and TFSA, but should limit the amounts to the maximum permitted contribution.

TIF Solution Ten - 8

Part A

Ms. Wheeler's net employment income for 2015 would be $20,800, her gross salary of $22,000, reduced by her RPP contributions of $1,200.

Part B

The annual addition for 2016 would be the lesser of $25,370 and 18 percent of Earned Income for 2015. The latter amount would be calculated as follows:

Net Employment Income (Part A)	$20,800
Add Back RPP Contributions	1,200
Spousal Support Received [(6)($1,200)]	7,200
Net Business Loss	(2,500)
Earned Income	$26,700
Percent	18%
Annual Addition (Less than $25,370)	$ 4,806

Ms. Wheeler's maximum deductible RRSP contribution would be calculated as follows:

Opening Unused Deduction Room	Nil
Annual Addition	$ 4,806
Less 2015 PA ($1,200 + $1,200)	(2,400)
Maximum Deductible RRSP Contribution	$ 2,406

Part C

As Ms. Wheeler has made no contributions prior to 2016, she has no undeducted contributions. In addition, she has interest income and dividends that are subject to current Tax Payable. Given this, as well as the fact that her lump-sum payment of $80,000 and $50,000 inheritance leaves her with cash in excess of her needs, she should contribute the maximum deductible amount of $2,406 for 2016.

While she could deduct the $2,406 in 2016, it would be advantageous to defer this deduction until 2017 when she expects to be in a higher tax bracket. At the federal level, the tax savings will be $626 [(26%)($2,406)] in 2017, as compared to $361 [(15%)($2,406)] in 2016.

Given her available funds, Ms. Wheeler should be advised to consider contributing the maximum allowable amount to a Tax Free Savings Account, as well as over contributing up to $2,000 to her RRSP. Although she would not be able to deduct these contributions, they would enjoy the benefit of having any income earned while in the plan compounded on a tax free basis. An over contribution to her RRSP would be deductible in a future year with sufficient RRSP deduction room.

All of these contributions should be made as soon as possible in order to maximize the tax free earnings that will accrue inside of her RRSP and/or TFSA.

TIF Solution Ten - 9

Part A

Donald's maximum 2016 RRSP deduction will include the lesser of $25,370 and 18 percent of his 2015 Earned Income. This latter figure is calculated as follows:

Gross Salary	$40,000
Commissions	20,000
Employment Expenses	(3,000)
Taxable Benefit On Loan	2,750
Net Rental Loss	(2,500)
Spousal Support Received	2,400
Spousal Support Paid	(3,500)
Royalties (Note)	Nil
Earned Income	$56,150
Percent	18%
Annual Addition (Less Than $25,370)	$10,107

Note Royalties received due to someone else's work are not part of Earned Income for RRSP purposes.

Donald's maximum 2016 RRSP deduction is calculated as follows:

Opening Unused RRSP Deduction Room	$25,000
Annual Addition	10,107
2015 Pension Adjustment [(2)($1,400)]	(2,800)
RRSP Deduction Limit For 2016	$32,307

The Pension Adjustment is equal to the sum of the employee and employer contributions to his money purchase RPP.

Part B

Since Donald wants to contribute the maximum allowable to his RRSP, the appropriate advice would be to contribute enough to make the maximum 2016 deduction, plus the allowed overcontribution of $2,000. This amount would be calculated as follows:

RRSP Deduction Limit For 2016	$32,307
Allowable Excess Amount	2,000
Non-Penalty Contribution Limit	$34,307
Undeducted Contributions From Previous Years	(7,500)
Maximum Contribution For 2016	$26,807

Given his available funds, Donald should be advised to also consider contributing the maximum allowable amount to a Tax Free Savings Account.

TIF Solution Ten - 10

Registered Pension Plan

His 2016 RPP contribution of $2,800 will be deductible in 2016.

Registered Retirement Savings Plan

Mr. Plate's maximum RRSP deduction would be calculated as follows:

Opening Unused Deduction Room	Nil
Annual Addition - Lesser Of:	
• 2016 RRSP Deduction Limit = $25,370	
• [(18%)($52,000)] = $9,360	$9,360
2015 Pension Adjustment ($2,500 + $2,500)	(5,000)
2016 RRSP Deduction Limit	$4,360

If he deducts the $4,360 limit for the year, he will have an unused contribution of $640 ($5,000 - $4,360) that can be carried forward for deduction in subsequent years.

TIF Solution Ten - 11

The annual addition for 2016 would be the lesser of $25,370 and 18 percent of Earned Income for 2015. The latter amount would be calculated as follows:

Salary	$86,200
Taxable Benefits	5,600
RPP Contributions (Note 1)	Nil
Union Dues	(450)
Net Employment Income (RRSP Figure)	$91,350
Business Loss	(4,500)
Rental Income	6,700
Common-Law Partner Support Paid	(12,000)
Eligible Dividends (Note 2)	Nil
Interest (Note 2)	Nil
2015 Earned Income	$81,550
Rate	18%
Annual Addition (Less Than $25,370)	$14,679

Note 1 While Ms. Storm's RPP contribution would be deducted in determining Net Income For Tax Purposes, it is not deducted in calculating employment income for RRSP Earned Income purposes.

Note 2 Neither the eligible dividends nor the interest are part of RRSP Earned Income.

Ms. Storm's maximum deductible RRSP contribution would be calculated as follows:

Opening Unused RRSP Deduction Room	$17,000
Annual Addition	14,679
2015 Pension Adjustment [(2)($2,500)]	(5,000)
RRSP Deduction Limit For 2016	$26,679
Undeducted Contributions From Prior Years	(8,000)
Maximum Deductible Contribution For 2016	$18,679

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Part A

Minimum Net Income For Tax Purposes would be calculated as follows:

Business Income	
Accounting Net Income	$183,000
Additions:	
Accounting Amortization	23,000
Recapture (Note 1)	12,000
Meals And Entertainment (Note 2)	7,000
Deductions:	
Maximum CCA (Given)	(31,000)
Accounting Gain On Asset Sale ($34,500 - $24,000)	(10,500)
Net Business Income	$183,500
Property Income	
Interest	1,200
Royalties	8,400
Taxable Capital Gains	
Taxable Capital Gain On Depreciable Assets (Note 3)	2,250
Taxable Capital Gain On Personal Assets	18,000
Allowable Capital Loss On Sale Of Shares	(1,000)
Other Deductions	
Spousal Support Paid	(3,600)
2016 Net Income Before RRSP Deduction	$208,750

Note 1 Recapture of CCA would be calculated as follows:

UCC - January 1, 2016	$18,000
Reduced By The Lesser Of:	
Capital Cost = $30,000	
Proceeds Of Disposition = $34,500	(30,000)
Negative Ending UCC Balance = Recapture Of CCA	($12,000)

Note 2 As only one-half of the $14,000 in deducted business meals and entertainment that were deducted in determining accounting Net Income can be deducted for tax purposes, $7,000 [(1/2)($14,000)] must be added back to accounting Net Income to arrive at Net Business Income.

Note 3 The taxable capital gain would be calculated as follows:

Depreciable Assets - Proceeds Of Disposition	$34,500
Capital Cost	30,000
Capital Gain On Depreciable Assets	$ 4,500
Inclusion Rate	1/2
Taxable Capital Gain	$ 2,250

Part B

Given that we are asked to assume the Alicia's 2015 Earned Income is equal to her 2016 Earned Income, we will need to calculate the 2016 figure. The calculations are as follows:

Net Business Income	$183,500
Royalties (Taxpayer Was Author)	8,400
Spousal Support Paid	(3,600)
Earned Income For RRSP Purposes	$188,300

Using this information, the maximum RRSP deduction for 2016 would be calculated as follows:

Unused Deduction Room - January 1, 2016	$ 6,500
Lesser Of:	
2016 RRSP Limit = $25,370	
[(18%)($188,300)] = $33,894	25,370
PA	N/A
Maximum RRSP Deduction For 2016	$31,870

The required amount of additional contributions would be calculated as follows:

Maximum 2016 Deduction	$31,870
Undeducted Contributions at January 1	(4,500)
Required Additional Contributions	$27,370

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Part A

Ms. Harcourt's net employment income for the year would be calculated as follows:

Gross Salary	$72,000
Registered Pension Plan Contributions	(4,200)
Union Dues	(360)
Bahamas Trip ($5,600 + $1,000)	6,600
Taxable Car Benefit (See Note)	18,376
Net Employment Income	$92,416

Note: The taxable benefit on the car would be calculated as follows:

Standby Charge [(2%)($59,890)(11)]	$13,176
Operating Cost Benefit [(20,000)($0.26)]	5,200
Total Benefit	$18,376

As Ms. Harcourt's employment related driving is less than 50 percent of the total, no reduction in the standby charge is available. This also means that she could not have based her operating cost benefit on 50 percent of the standby charge, even if it had been advantageous.

Other Notes

- As the trip was a performance related award, the $500 gift exemption is not applicable.
- The Canada Pension Plan and Employment Insurance premiums can be used for tax credits, but cannot be deducted from any source of income.
- Income taxes and the parking fees withheld cannot be deducted against income.
- Donations to the United Way create a tax credit for individuals but cannot be deducted from any source of income.
- In general, IT-470R indicates that discounts on an employer's merchandise do not generate a taxable benefit.

Part B

Ms. Harcourt's Earned Income for 2015, which is equal to her Earned Income for 2016, is as follows:

Net Employment Income (Part A)	$92,416
Registered Pension Plan Contributions	4,200
Net Rental Loss	(3,900)
Business Loss	(24,600)
Earned Income	$68,116

Her maximum deductible RRSP contribution for 2016 is as follows:

Unused Deduction Room - End Of 2015	$ 4,500
Annual Addition - Lesser Of:	
• 2016 RRSP Dollar Limit = $25,370	
• 18% Of 2015 Earned Income Of $68,116 = $12,261	12,261
Less 2015 PA	(7,000)
Maximum Deductible RRSP Contribution	$ 9,761

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Retiring Allowance Rollover

If Mr. White accepts his employer's offer of cash, he has two alternative courses of action. First, he can do nothing, in which case the full $68,000 will be an addition to his Net Income For Tax Purposes for the current year. His second alternative will be to transfer some part of the payment to a Registered Retirement Savings Plan (RRSP) on a tax free basis. While he will still have to include the full $68,000 in his income, he will be eligible for a deduction equal to a specified amount of such transfers.

The rules prior to 1989 permit tax free transfers of up to $2,000 per year of service with the employer who is making the payments, plus an additional $1,500 per year of service for each year during which the employer was not making vested contributions to either a Registered Pension Plan or a Deferred Profit Sharing Plan. For 1989 through 1995, the amount of this transfer is limited to $2,000 per year of post-1988 service. For service after 1995, the transfer is no longer available.

In 2016, Mr. White's limit would be $31,500 [(12 years)($2,000) + (5 years)($1,500)]. The excess of $36,500 ($68,000 - $31,500) will be taxed in the year in which it is received.

Alternatives Available

As to the appropriate course of action, it depends on Mr. White's circumstances. If he anticipates finding another job within a short period of time and has no immediate need for the additional cash, the tax free transfer to an RRSP is probably the most appropriate course of action. He could use the excess retiring allowance to make his maximum regular RRSP contribution.

Although he could make a non-deductible RRSP contribution of up to $2,000 without being assessed any penalty, there are other alternative savings plans available to him. If he has available funds, he should consider contributions to an RESP for the triplets and TFSAs for himself and his wife.

On the other hand, if he wishes to take some time off, or is uncertain as to his future job prospects, he may wish to retain all of the cash on a personal basis. Note, however, if the offer is accepted late in the year after Mr. White has received most of his annual income, the retention of the additional $68,000 would likely push Mr. White into the highest tax bracket. This could be avoided by putting the maximum of $31,500 into an RRSP, with funds withdrawn as needed in the following year.

Another possibility is that Mr. White is at or near retirement age. If this is the case, he will probably wish to transfer the maximum of $31,500 to an RRSP in order to gain flexibility in terms of when the income will be taxed during his retirement years.

If the funds are subsequently transferred to a RRIF or withdrawn from the RRSP in the form of an annuity, the payments will be eligible for the pension income tax credit after Mr. White reaches age 65. The RRIF and annuity payments will also be eligible for the pension income splitting provisions (see Chapter 9).

As a final note, if Mr. White chooses to make a tax free transfer to an RRSP, the transaction does not change his RRSP Deduction Limit for the year. That is, the maximum deductible RRSP contribution for 2016 will be the same, whether or not he transfers part of the retiring allowance into his plan.

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Part A - RRSP Contribution

In order to determine his maximum RRSP deduction for 2016, we need to calculate Mr. Arnold's Earned Income for 2015. The calculation is as follows:

Net Employment Income	$93,000
Registered Pension Plan Contributions (Add Back)	4,000
Net Rental Loss	(7,000)
Net Business Income	9,000
2015 Earned Income	$99,000

His maximum deductible RRSP contribution for 2016 is calculated as follows:

Unused Deduction Room - End Of 2015	$ 6,200
Annual Addition - Lesser Of:	
• 2016 RRSP Dollar Limit = $25,370	
• 18% Of 2015 Earned Income Of $99,000 = $17,820	17,820
Less 2015 PA	(8,000)
Maximum Deductible RRSP Contribution	$16,020

Part B

Net Employment Income

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

Gross Salary	$103,000
Additions:	
Commission Income	26,140
Taxable Car Benefit (Note One)	3,503
Disability Benefit (Note Two)	6,150
Hotel Allowance (Note Three)	Nil
Gift Certificate (Note Four)	750
Award (Note Four)	300
Deductions:	
Registered Pension Plan Contributions	(4,200)
Union Dues	(260)
Employment Expenses (Note Five)	(6,570)
Net Employment Income	$128,813

Note One The taxable benefit on the car would be calculated as follows:

Standby Charge [(2%)($38,000)(10)(6,000 ÷ 16,670)]	$2,735
Operating Cost Benefit - Lesser Of:	
• [(6,000)($0.26)] = $1,560	
• [(1/2)($2,735)] = $1,368	1,368
Total Benefit Before Payments For Personal Use	$4,103
Payments For Personal Use Of The Car	(600)
Taxable Benefit	$3,503

As Mr. Arnold's employment related driving is more than 50 percent of the total, he is eligible for the reduced standby charge calculation. This also means that he is eligible to use the alternative operating cost benefit calculation based on one-half the standby charge and this approach produces the lower operating cost benefit.

Note Two As Mr. Arnold's employer contributes to the disability plan, the $10,950 benefit must be included in income. However, the amount can be reduced by the $4,800 [($1,200)(4 Years)] contributions that he made in 2013 through 2016. This leaves a net inclusion of $6,150 ($10,950 - $4,800).

Note Three As the $4,800 hotel allowance appears to be reasonable, it will not be included in Mr. Arnold's income. As it is not included in his income, he cannot deduct the actual costs of $5,100.

Note Four The department store gift certificate would be viewed as a near cash award and would not be eligible for the $500 annual gift exemption. Performance awards must always be included in income.

Note Five As Mr. Arnold has commission income, he can deduct a pro rata share of insurance and property taxes in addition to a pro rata share of utilities and maintenance. However, as an employee, he cannot deduct the mortgage interest or CCA. Also deductible because of Mr. Arnold's commission income is 50 percent of the client meals and entertainment. This provides total deductible expenses as follows:

Utilities And Maintenance	$ 5,000
Insurance	4,500
Property Taxes	7,600
Total Home Costs	$17,100
Workspace Share	20%
Deductible Home Workspace Costs	$ 3,420
Business Meals And Entertainment [(50%)($6,300)]	3,150
Total Employment Expenses Deduction	$ 6,570

As this total is less than Mr. Arnold's commission income, he does not need to consider any alternative calculation of deductible expenses.

Net Income For Tax Purposes And Taxable Income

As Mr. Arnold has no deductions applicable to the determination of Taxable Income, his Taxable Income is equal to his Net Income For Tax Purposes. Mr. Arnold's Net Income For Tax Purposes and Taxable Income would be calculated as follows:

Employment Income (See Preceding Calculations)	$128,813
Taxable Capital Gains (Given)	4,500
Net Rental Loss (Given)	(6,000)
Net Business Income (Given)	8,600
RRSP Deduction (Part A)	(16,020)
Net Income For Tax Purposes And Taxable Income	$119,893

Tax Payable

The required calculations here are as follows:

Tax On First $90,563		$16,075
Tax On Next $29,330 ($119,893 - $90,563) At 26 Percent		7,626
Tax Before Credits		$23,701
Tax Credits:		
Basic Personal Amount	($11,474)	
Spousal ($11,474 - $8,500)	(2,974)	
Employment Insurance	(955)	
Canada Pension Plan	(2,544)	
Canada Employment	(1,161)	
Medical Expenses (Note Three)	(11,513)	
Total Credit Base	($30,621)	
Rate	15%	(4,593)
Charitable Donations (Note Four)		(1,016)
Federal Tax Payable		$18,092

Note Three The base for Mr. Arnold's medical expense credit would be calculated as follows:

Allen	$ 3,650
Brenda	2,600
Sarah	1,300
Derek	6,200
Total	$13,750
Lesser Of:	
• [(3%)($119,893)] = $3,597	
• 2016 Threshold Amount = $2,237	(2,237)
Tax Credit Base	$11,513

Note Four As Arnold's Taxable Income is less than $200,000, the 33 percent tax rate is not relevant to the calculation of his charitable donations tax credit. Given this, the credit is $1,016 [(15%)($200) + (29%)($1,200 + $2,400 - $200)].

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Part A - RRSP Contribution

In order to determine his maximum RRSP deduction for 2016, we need to calculate his Earned Income for 2015. The calculation is as follows:

Net Employment Income	$77,000
Registered Pension Plan Contributions	3,200
Net Rental Loss	(9,000)
Net Business Loss	(5,000)
2015 Earned Income	$66,200

His maximum deductible RRSP contribution for 2016 is calculated as follows:

Unused Deduction Room - End Of 2015	$ 3,400
Annual Addition - Lesser Of:	
• 2016 RRSP Dollar Limit = $25,370	
• 18% Of 2015 Earned Income Of $66,200 = $11,916	11,916
Less 2015 PA	(6,400)
Maximum Deductible RRSP Contribution	$ 8,916

Part B

Net Employment Income

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

Gross Salary	$76,000
Commission Income	2,800
Registered Pension Plan Contributions	(3,500)
Union Dues	(360)
Taxable Car Benefit (Note One)	5,391
Employment Expenses (Note Two)	(4,300)
Net Employment Income	$76,031

Note One The taxable benefit on the car would be calculated as follows:

Standby Charge {[(2/3)($642)(11)][14,000 ÷ 18,337]}	$3,594
Operating Cost Benefit - Lesser Of:	
• [(14,000)($0.26)] = $3,640	
• [(1/2)($3,594)] = $1,797	1,797
Total Benefit	$5,391

As Mr. Sali's employment related driving is more than 50 percent of the total, he is eligible for the reduced standby charge calculation. This also means that he is eligible to use the alternative operating cost benefit calculation based on one-half the standby charge and this approach produces the lower operating cost benefit.

Note Two Mr. Sali can deduct home office costs of $600 in utilities and maintenance under ITA 8(1)(i) which is available to all employees. As Mr. Sali has commission income, he has a choice of deducting his expenses under ITA 8(1)(f) or, alternatively under ITA 8(1)(h). As discussed in Chapter 3, he cannot use both ITA 8(1)(f) and ITA 8(1)(h).

If he uses ITA 8(1)(h) and (i), he can deduct his non-reimbursed travel costs of $3,700 for a total of $4,300 ($600 + $3,700). Alternatively, under ITA 8(1)(f) and(i), he can deduct the following:

Home Office Costs - Insurance	$ 900	
Home Office Costs - Property Taxes	1,200	
Non-Reimbursed Travel Costs	3,700	
Total Under ITA 8(1)(f)	$5,800	
Limited To Commission Income of $2,800		$2,800
Home Office Costs - Utilities And Maintenance		600
Total Under ITA 8(1)(f) and (i)		$3,400

Unfortunately, if ITA 8(1)(f) is used, the deduction under ITA 8(1)f) is limited to the $2,800 of commission income. Clearly, Mr. Sali would be better off using ITA 8(1)(h) and (i) and deducting a total of $4,300.

Other Notes The parking fees at the company's garage are not deductible. The personal use of frequent flyer points earned when traveling for an employer does not usually result in a taxable benefit. Although the Edmonton trip is employment related, Mr. Sali will not be able to deduct any amount for the points used.

Net Income For Tax Purposes And Taxable Income

As Mr. Sali has no deductions applicable to the determination of Taxable Income, his 2016 Taxable Income is equal to his 2016 Net Income For Tax Purposes. Mr. Sali's Net Income For Tax Purposes and Taxable Income would be calculated as follows:

Employment Income (See Preceding Calculations)	$76,031
Taxable Capital Gains (Given)	6,200
Net Rental Loss (Given)	(3,900)
Net Business Loss (Given)	(2,600)
Eligible Dividends	2,500
Gross Up Of 38 Percent	950
RRSP Deduction (Part A)	(8,916)
Net Income For Tax Purposes And Taxable Income	$70,265

Tax Payable

The required calculations here are as follows:

Tax On First $45,282		$ 6,792
Tax On Next $25,983 ($70,265 - $45,282) At 20.5 Percent		5,122
Tax Before Credits		$11,914
Tax Credits:		
Basic Personal Amount	($11,474)	
Employment Insurance	(955)	
Canada Pension Plan	(2,544)	
Canada Employment	(1,161)	
Medical Expenses (Note Three)	(1,142)	
Total Credit Base	($17,276)	
Rate	15%	(2,591)
Charitable Donations (Note Four)		(610)
Dividend Tax Credit On Eligible Dividends [(6/11)($950)]		(518)
Federal Tax Payable		$8,195

Note Three The base for Mr. Sali's medical expense tax credit would be his unreimbursed expenses of $3,250 [(1 - 0.8)($16,250)], reduced by the lesser of $2,108 [(3%)($70,265)] and $2,237. This amount would be $1,142 ($3,250 - $2,108).

Note Four As Ron's Taxable Income is less than $200,000, the 33 percent tax rate is not relevant to the calculation of his charitable donations tax credit. Given this, the credit is $610 [(15%)($200) + (29%)($800 + $1,400 - $200)].