Chapter Eleven Test Item File Solutions

TIF Solution Eleven - 1

1. Such lump-sum payments often reflect compensation for services rendered over several years. The fact that it is received in a single year can result in significant portions of it being taxed at rates higher than would have been applicable had it been received over the several years during which it was earned. The deduction of such amounts provides the basis for an alternative Tax Payable calculation which attempts to adjust the amount paid to the amount that would have been paid if the amount had been received over several years. The objective of such provisions is fairness or equity.

2. The carry forward periods for the various types of losses identified in the *Income Tax Act* and covered in the text up to Chapter 11 are as follows:

    - Non-Capital Losses and Farm Losses: 20 years.
    - Net Capital Loss: Unlimited.
    - Listed Personal Property Losses: 7 years.
    - Allowable Business Investment Losses: 10 years, then converted to net capital loss with unlimited carry forward.

    Covered in Chapter 18 are limited partnership losses. They have no carry back and an unlimited carry forward, but only against the partnership income to which they relate.

3. There are two reasons for having to track each type of loss carry forward separately. First, different types of losses have different carry forward periods (e.g., 20 years for farm losses vs. unlimited for capital losses). Second, some types of losses can only be applied against the equivalent type of income (e.g., capital losses can only be carried over and applied against capital gains).

4. This recommendation reflects the fact that most tax credits are non-refundable and cannot be carried over to past or future years. This means that, unless a taxpayer has Taxable Income and Tax Payable, the value of these credits is simply lost. This, in effect, is what would happen if various types of loss carry overs were used to reduce Taxable Income to Nil.

5. Losses on listed personal property can be deducted during the current year, but only against gains on listed personal property. If the loss cannot be used during the current year, it can be carried back three years or forward seven years. However, in the carry back or carry forward years, it can only be deducted to the extent of capital gains on listed personal property during those years.

6. There is no clear cut answer to this question. Net capital losses have an unlimited life but can only be carried over to the extent of net taxable capital gains in the carry over year. This would suggest that, if net taxable capital gains are present in the current year, the use of net capital losses should receive priority. This would be particularly true if additional net taxable capital gains are not expected in future years. In contrast, non-capital losses can be deducted against any type of income. However, the downside here is that their carry forward period is limited to 20 years. While no firm conclusion is available, in most cases the lengthy carry forward period for non-capital losses, would suggest using net capital losses first. However, this tentative conclusion would be altered if the taxpayer commonly has net taxable capital gains.

7. The difference between the two loss carry forwards is that the non-capital loss balance is time limited and will expire at the end of 20 years. In contrast, the net capital loss will never expire but can only be applied against taxable capital gains. If Mr. Broley is concerned about having sufficient income to use the non-capital balance in the time remaining until it expires, he should deduct that balance. Alternatively, if he feels that he is likely to have sufficient income in that period, but that he is unlikely to have further

capital gains, he should deduct the net capital loss. There is no clear answer to this question as it involves estimates about the future.

8. ITA 111(2) contains a special provision with respect to both net capital losses from years prior to death and to net capital losses arising in the year of death. Essentially, this provision allows these accumulated losses to be applied against any type of income in the year of death, or the immediately preceding year, as long as the lifetime capital gains deduction has not been claimed. A further difference is that, in the case of carry overs, the deduction in the year of death is applied using the capital gains inclusion rate (1/2, 2/3, or 3/4) that prevailed in the year the loss was realized, rather than at the rate that applies in the year of deduction.

9. An Allowable Business Investment Loss (ABIL) is the deductible portion of a capital loss resulting from the disposition of shares or debt of a small business corporation. The special provisions associated with this type of loss are:

   - It can be deducted against any type of income in the year in which it occurs.
   - It can be carried back and applied against any type of income in the preceding 3 taxation years.
   - If it cannot be used during the current or 3 preceding years, it becomes part of the non-capital loss carry forward balance and can be deducted against any type of income in the 10 subsequent years.
   - If it is not used in the subsequent 10 years, it becomes part of the net capital loss balance and can be carried forward indefinitely, subject to the constraint that during these additional years, it can only be deducted against taxable capital gains.
   - It is disallowed as an ABIL (i.e., it becomes a regular allowable capital loss), to the extent that the taxpayer has used the ITA 110.6 lifetime capital gains deduction.
   - The realization of an ABIL reduces the annual gains limit that is used to determine the maximum deduction under ITA 110.6.

10. A small business corporation is defined in ITA 248(1) as a Canadian controlled private corporation (CCPC) of which "all or substantially all”, of the fair market value of its assets are used in an active business carried on “primarily” in Canada. In tax work, the term “substantially all” generally means 90 percent or more, while “primarily” is generally interpreted to mean more than 50 percent.

11. The three categories, along with the treatment of their losses, are as follows:

    Hobby Farmer This is an individual who runs a farming operation on a part time basis as a hobby or as a way of enhancing his lifestyle. The operation has no reasonable expectation of a profit and its losses cannot be deducted against any other source of income.

    Part Time Farmer This is an individual for whom farming is subordinate to some other source of income. However, if there is a reasonable expectation of a profit, the farmer is allowed to deduct a portion of his farm losses. In each year, the portion of the farm loss that can be deducted against any source of income is limited to the first $2,500, plus one-half of the next $30,000, to a maximum amount of $17,500. Losses in excess of this deductible amount are referred to as restricted farm losses and, when they are carried over to earlier or later years, they can only be deducted to the extent of farm income in that year.

    Full Time Farmer This is an individual for whom farming is his principal source of income and activity. For this category of farmer, farm losses are fully deductible against any other source of income.

12. In order to be a qualified small business corporation for the purposes of the lifetime capital gains deduction, the corporation must be a "small business corporation" at the time of the disposition of the shares. This means that substantially all (90 percent or more) of the fair market value of its assets must be used to produce active business income, primarily (more than 50 percent) in Canada. If the small business corporation test is met, two other conditions must be met for the enterprise to be a "qualified" small business. These are as follows:

    - the shares must not be owned by anyone other than the taxpayer or a related person for at least 24 months preceding the disposition; and
    - throughout this 24 month period, more than 50 percent of the fair market value of the corporation's assets must be used in an active business carried on primarily in Canada.

13. In these circumstances, the annual gains limit is equal to the taxable capital gain on the qualified farm property, less:

    - Allowable capital losses realized during the current year.
    - Net capital loss carry overs from previous deducted in the current year.
    - Allowable Business Investment Losses realized during the current year.

14. Most subdivision e deductions such as child care expenses cannot be carried forward to other taxation years. This means that, if they are not deducted during the current taxation year, they are lost forever. In contrast, business and property losses can be both carried back to previous taxation years and forward to subsequent taxation years. In contrast to subdivision e deductions, business and property losses are not lost if they are not deducted during the current taxation year. This means that, in situations where there is not sufficient income to deduct all available amounts, it will generally be desirable to deduct any subdivision e deductions first. This prevents a permanent loss of these deductions.

15. Non-capital losses would include current year employment losses, most business losses, property losses, and allowable business investment losses. The definition excludes farm losses (a type of business loss) and current year capital losses, but does include net capital losses carried over from other years and deducted in the current year.

16. The items that are included in the split income definition are as follows:

    (a) taxable dividends from private companies received directly, or through a trust or partnership;

    (b) shareholder benefits or loans received from a private corporation; and

    (c) income from a partnership or trust if the income is derived from the provision of property or services to a business:
        - carried on by a person related to the individual,
        - carried on by a corporation of which a person related to the individual is a specified shareholder (i.e., owns 10 percent or more of the shares), or
        - carried on by a professional corporation of which a person related to the individual is a shareholder.

    In addition to these items, capital gains resulting from a sale of shares by a specified individual to a non-arm's length person are included, provided any taxable dividends on those particular shares would have been subject to the tax on split income. This is accomplished by deeming such capital gains to be non-eligible dividends.

17. The required three items could be selected from the following items that are listed in the text:

- dividends from public companies;
- reasonable remuneration paid to a minor;
- amounts paid to a minor with no parent who is resident in Canada;
- income from property inherited by a child from a parent; or
- income from property inherited from individuals other than a parent, if the child is either in full time attendance at a post-secondary educational institution, or eligible for the disability tax credit.

18. Dividends can be transferred from a spouse or common-law partner if they serve to create or increase the taxpayer's spousal tax credit.

19. As presented in the text, the descriptions are as follows:

    1. **Total Charitable Gifts** is defined to include all eligible amounts donated by an individual to a registered charity, a registered Canadian amateur athletic association, a Canadian municipality, the United Nations or an agency thereof, a university outside of Canada which normally enrolls Canadian students, and a charitable organization outside of Canada to which Her Majesty in right of Canada has made a gift in the year or in the immediately preceding year.
    2. **Total Crown Gifts** is defined as the aggregate of eligible amounts donated to Her Majesty in right of Canada or a province.
    3. **Total Cultural Gifts** is defined as the aggregate of all eligible gifts of objects that the Canadian Cultural Property Export Review Board has determined meet the criteria of the *Cultural Property And Import Act*.
    4. **Total Ecological Gifts** is defined as all eligible gifts of land certified by the Minister of the Environment to be ecologically sensitive land, the conservation and protection of which is important to the preservation of Canada's environmental heritage. The beneficiary of the gift must be a Canadian municipality or a registered charity, the primary purpose of which is the conservation and protection of Canada's environmental heritage.

20. Donations in excess of $200 provide the donor with a federal tax credit equal to either 29 percent or 33 percent of the amount of the donation (the rate depends on the Taxable Income of the taxpayer). If the donation involves a non-depreciable asset, electing the higher fair market value will result in a capital gain, only one-half of which will be taxed. This means that the effective tax rate for a taxpayer in the highest tax bracket on the excess amount elected is only 16.5 percent [(1/2)(33%)]. This assures the taxpayer that the value of the credit resulting from the extra amount elected will be at least double the increase in tax on the resulting capital gain.

21. When there is a disposition of publicly traded shares that have been acquired through stock options, the difference between the fair market value at the time the shares were exercised and the option price at which they were acquired is treated as employment income, not as a capital gain. While the general rule under ITA 38(a.1) deems capital gains on such donations to be nil, a special rule is required to exempt the employment income which may arise on such dispositions. The solution takes the form of an additional deduction under ITA 110(1)(d.01).

22. Both credits are based on the lesser of the amount withheld and an amount determined by the following formula:

    [Foreign Non-Business Income ÷ Adjusted Division B Income][Tax Otherwise Payable]

    The differences are as follows:

    - For individuals, the figure used for the amount withheld for the non-business foreign credit is limited to 15 percent of the foreign non-business income. Any amount of withholding in excess of 15 percent becomes a deduction in the determination of Net Income For Tax Purposes. There is no such limit on the actual amount for the foreign business income credit.
    - When the amount withheld on foreign business income exceeds the amount that can be deducted, the excess can be carried back 3 years and forward 10 years to apply against tax payable in those years. If the amount of foreign non-business taxes withheld exceeds the amount that can be deducted, the taxpayer can deduct such amounts in the determination of Net Income For Tax Purposes.
    - The foreign business income credit is further limited by the amount of tax otherwise payable, reduced by any foreign non-business tax credit taken in the year. In effect, the credit is the least of the actual amount withheld, the amount determined by the formula, and tax otherwise payable reduced by any foreign non-business tax credit.

23. The tax policy issue is the fact that some individuals, through the use of tax privileges (e.g., lifetime capital gains deduction, the non-taxable component of capital gains, or employee stock option deductions) can wind up paying little or no tax, despite having a very large income. The alternative minimum tax deals with this by requiring an alternative calculation of income in which these tax privileges are added back. After the deduction of a basic $40,000 exemption, the minimum tax rate is applied to the balance. If the result is a Tax Payable figure that is larger than that resulting from the regular calculation, this amount must be paid. Any excess of alternative minimum tax over regular Tax Payable can be carried forward for up to seven years to be applied against any future excess of regular Tax Payable over the alternative minimum tax.

TIF Solution Eleven - 2

1. False. There are other deductions that can create a difference between Net Income For Tax Purposes and Taxable Income.

2. False. It can be carried back 3 years and forward 20 years.

3. False. The Allowable Business Investment Loss is $10,000 [(1/2)($20,000)].

4. False. Its net allowable capital loss for the year is $5,500 [(1/2)($11,000)].

5. True. Net capital losses can only be carried forward or back to be deducted against net taxable capital gains.

6. i. False. In the current year, she can deduct a maximum of $10,250 [$2,500 + (1/2)($18,000 - $2,500)] of the farm loss against other income.

   ii. False. Any loss that is not deductible in the current year can be carried forward for a maximum of 20 years.

   iii. True. A restricted farm loss can only be used to the extent of farm income in the carry over period.

7. True. The $412,088 deduction can be used against gains arising on the disposition.

8. True. The foreign tax credit deductible from federal Tax Payable cannot exceed 15 percent of the foreign investment income that, in this case, is $1,500. The remaining $500 would be deductible under ITA 20(11).

9. True. ITA 82(3) only allows such transfers when the spousal credit is either created or increased for the taxpayer.

10. True. Any gain would be deemed to be nil.

TIF Solution Eleven - 3

New For 2016/2017

1. B. $3,875 [($300,000)(2.5% - 1.0%) - ($25,000)(2.5%)]

2. C. Net capital loss carry overs cannot be deducted in years in which Net Income For Tax Purposes is nil, even if there are taxable capital gains in that year.

3. D. $48,000

Loss On Disposition		$30,000
Disallowed By Use Of ITA 110.6		(20,000)
Business Investment Loss		$10,000
Inclusion Rate		1/2
Allowable Business Investment Loss		$5,000
Employment Income		$50,000
Taxable Capital Gain [(1/2)($26,000)]	$13,000	
Disallowed Loss [(1/2)($20,000)]	(10,000)	3,000
Allowable Business Investment Loss		(5,000)
Net And Taxable Income		$48,000

4. C. For 2016, the maximum deduction for qualified small business corporations is different than the maximum deduction for qualified farm corporations.

5. B. $4,024 [(33%)(117%)($15,300) – (21/29)(17%)($15,300)]

6. A A decrease of $1,040.

Increase In Tax Payable [(20.5%)(138%)($9,000)]	$2,546
Increase In Spousal Tax Credit [(15%)($11,474)]	(1,721)
Dividend Tax Credit [(38%)(6/11)($9,000)]	(1,865)
Increase (Decrease) In Tax Payable	($1,040)

7. C. The basis for a charitable donations tax credit for the current year can never exceed 75 percent on the individual's Net Income For Tax Purposes.

8. B. $2,471

The credit would be the lesser of $4,500 [($30,000)(15%)] and an amount determined by the following formula:

[$30,000 ÷ ($102,000 - $10,000)][$7,579] = $2,471

Retained From Previous Editions

9. D. A credit for a charitable donation.

10. A. A non-capital loss carried forward from a previous year.

11. C. i and iv.

12. D. Mr. Chechetto can use a special relief mechanism in the Income Tax Act which will have the effect of spreading the lump-sum payment over the 8 taxation years affected.

13. C. If a gain occurs, one-half of this amount can be offset by allowable capital losses on any disposition of capital property.

14. A. Nil.

15. D. Such balances can be carried forward for 20 years.

16. B. $3,800. [$15,000 - $18,000 + ($1,200 - $2,000)

17. D. Business losses.

18. D. It is never advisable to use a loss carry over to reduce taxable income to nil in the carry over year.

19. A. Listed personal property losses.

20. B. $28,000. [$25,000 + (1/2)($8,000) +(1/2)($6,000) - (1/2)($8,000) (LPP loss carry forward can only be used against LPP gains in calculation of Net Income For Tax Purposes)]

21. C. $91,250. [$90,000 + $5,000 – carry forward of $3,750). Deducted $6,250 [$2,500 + (1/2)($10,000 - $2,500). This leave a carry forward of $3,750 ($10,000 - $6,250)

22. D. If they are not used during the current year, they are added to the non-capital loss balance.

23. B. If not used during the current year, an Allowable Business Investment Loss can only be applied against taxable capital gains in a carry forward or carry back period.

24. B. An individual sells 15 percent of the shares of a CCPC that uses 95 percent of its assets in the operation of an active business.

25. D. The deduction is available on any disposition of shares or debt of a qualified small business corporation.

26. C. The shares must not have been owned by a related individual in the past 24 months.

27. C. Loss carryovers.

28. C. Within a particular type of loss, the oldest losses must be utilized first.

29. B. The tax is applied at a 33 percent rate to all of the income of a specified individual.

30. A. Employment income earned by a specified individual from a private corporation.

31. D. $3,156 [(33%)(117%)($12,000) – (21/29)(17%)($12,000)]

32. B. If Mr. Mantz is in the 15 percent federal tax bracket.

33. C. $139,500 [(75%)($147,500) + (25%)(1/2)($300,000 - $225,000) + (25%)($225,000 - $147,000)]

34. A. A donation to a charitable organization outside of Canada to which the taxpayer's province of residence has also made a donation.

35. A. Business income only.

36. C. Foreign interest income.

37. B. The Foreign Non-Business Income Tax Credit is limited to 15% of the foreign non-business income.

38. C. Business income from a contract with a foreign entity

39. B. Dividend tax credits.

40. A. Stock options not yet exercised.

TIF Solution Eleven - 4

Exam Exercise Solution Eleven - 1 (Listed Personal Property Losses)

Ms. Michaels will have a listed personal property loss carry forward from 2015 of $12,000 [(1/2)($78,000 - $102,000)]. This can be applied against the 2016 taxable capital gain on listed personal property of $2,950 [(1/2)($7,000 - $1,100)]. Based on this, her Net and Taxable Income would be calculated as follows:

Income Under ITA 3(a)	$69,000
Income Under ITA 3(b) ($2,950 - $2,950)	Nil
Net Income For Tax Purposes And Taxable Income	$69,000

In this case, there is a listed personal property loss carry forward of $9,050 ($12,000 - $2,950) that can only be applied against taxable capital gains on listed personal property.

If the sale had been of shares, Ms. Michaels would have had a regular net capital loss carry forward of $12,000 from 2015. Her Net and Taxable Income would be calculated as follows:

Income Under ITA 3(a)	$69,000
Income Under ITA 3(b)	2,950
Net Income For Tax Purposes	$71,950
Loss Carry Forward (Limited To Taxable Capital Gains)	(2,950)
Taxable Income	$69,000

In this case, the net capital loss carry forward of $9,050 can be applied against any taxable capital gains. While the Taxable Income figure is not changed, Net Income For Tax Purposes is different.

Exam Exercise Solution Eleven - 2 (Listed Personal Property Losses)

At the beginning of 2016, Mr. Legal will have a carry forward of a listed personal property loss in the amount of $15,000 [(1/2)($150,000 - $120,000)]. For the year 2016, he will have a taxable capital gain of $26,500 [(1/2)($125,000 - $72,000)]. As the listed personal property loss carry forward cannot be deducted against this type of gain, Mr. Legal's Net Income For Tax Purposes and his Taxable Income will be $26,500. This will leave the $15,000 listed personal property loss carry forward balance unchanged.

If the 2015 loss had been on publicly traded securities, it would have been a regular capital loss and could be applied as follows:

2016 Net Income For Tax Purposes	$26,500
Loss Carry Forward (Less Than Taxable Capital Gain)	(15,000)
Taxable Income	$11,500

There would be no remaining capital loss carry forward.

Exam Exercise Solution Eleven - 3 (Loss Carry Overs)

The original 2015 result is as follows:

Business Income	$19,000
Taxable Capital Gain	3,000
Net Income For Tax Purposes	$22,000
Deductions	Nil
Taxable Income	$22,000

His 2016 Net Income For Tax Purposes and Taxable Income would be nil.

After the maximum carry backs from 2016, the amended 2015 results would be as follows:

Business Income	$19,000
Taxable Capital Gain	3,000
Net Income For Tax Purposes	$22,000
Net Capital Loss Carry Back (Limited To Taxable Capital Gain)	(3,000)
Non-Capital Loss Carry Back (Reduces Taxable Income To Nil)	(19,000)
Amended Taxable Income	Nil

At the end of 2016, the remaining loss carry forwards would be as follows:

- Net Capital Loss Carry Forward = [(1/2)($9,800 - $3,200) - $3,000] = $300
- Non-Capital Loss Carry Forward = ($56,000 - $19,000) = $37,000

Exam Exercise Solution Eleven - 4 (Loss Carry Overs)

The original 2015 result is as follows:

Business Income	$28,000
Taxable Capital Gain	6,500
Net Income For Tax Purposes	$34,500
Deductions	Nil
Taxable Income	$34,500

Her 2016 Net Income For Tax Purposes and Taxable Income would be nil.

After maximum carry backs from 2016, the results would be as follows:

Business Income	$28,000
Taxable Capital Gain	6,500
Net Income For Tax Purposes	$34,500
Net Capital Loss Carry Back (Limited To Taxable Capital Gain)	(6,500)
Non-Capital Loss Carry Back (Reduces Taxable Income To Nil)	(28,000)
Amended Taxable Income	Nil

At the end of 2016, the remaining loss carry forwards would be as follows:

- Net Capital Loss Carry Forward = ($10,800 - $6,500) = $4,300
- Non-Capital Loss Carry Forward = ($85,000 - $28,000) = $57,000

Exam Exercise Solution Eleven - 5 (Loss Carry Overs)

For 2015, Ms. Claus had Net Income For Tax Purposes and Taxable Income of $45,000. At the end of this year, she had a net capital loss carry forward of $5,250.

For 2016, she has a net taxable capital gain of $3,150 [(1/2)($12,600 - $6,300)], providing for a carry forward from 2015 of this amount as part of the non-capital loss balance. Based on this course of action, the 2016 non-capital loss would be calculated as follows:

Amount E ($83,000 + $3,150)	$86,150
Income Under ITA 3(c)	(3,150)
Non-Capital Loss	$83,000

Of this amount, $45,000 can be carried back to 2015, resulting in an amended return for that year as follows:

Net Income for Tax Purposes	$45,000
Non-Capital Loss Carry Back	(45,000)
Amended Taxable Income	Nil

At the end of 2016, the following loss carry forwards remain:

- Net Capital Loss Carry Forward = ($5,250 - $3,150) = $2,100
- Non-Capital Loss Carry Forward = ($83,000 - $45,000) = $38,000

Exam Exercise Solution Eleven - 6 (Loss Carry Overs)

For 2015, Dora had Net Income For Tax Purposes and Taxable Income of $95,000. At the end of this year, she had a net capital loss carry forward of $9,250.

For 2016, she has a net taxable capital gain of $7,200, providing for a carry forward from 2015 of this amount as part of the non-capital loss balance. Based on this course of action, the 2016 non-capital loss would be calculated as follows:

Amount E ($123,000 + $7,200)	$130,200
Income Under ITA 3(c)	(7,200)
Non-Capital Loss	$123,000

Of this amount, $95,000 can be carried back to 2015, resulting in an amended return for that year as follows:

Net Income for Tax Purposes	$95,000
Non-Capital Loss Carry Back	(95,000)
Amended Taxable Income	Nil

At the end of 2016, the following loss carry forwards remain:

- Net Capital Loss Carry Forward = ($9,250 - $7,200) = $2,050
- Non-Capital Loss Carry Forward = ($123,000 - $95,000) = $28,000

Exam Exercise Solution Eleven - 7 (Net Capital Losses At Death)

The net amount that would be included in Ms. Forester's income as a result of these items would be calculated as follows:

Employment Income	$47,000
Taxable Capital Gain	15,500
Net Capital Loss Applied Against Current Taxable Capital Gain [(1/2)($31,000)]	(15,500)
Net Capital Loss Applied Against Other Income [(3/4)($42,000 - $31,000)]	(8,250)
Net Inclusion	$38,750

As it is Ms. Forester's year of death, the net capital loss can be deducted against any type of income. Note that the carry forward amount must be adjusted for application against current taxable capital gains, but does not require adjustment for application against other types of income.

Exam Exercise Solution Eleven - 8 (Net Capital Losses At Death)

The net amount that would be included in Barton's final tax return as a result of these items would be calculated as follows:

Employment Income	$61,000
Taxable Capital Gain [(1/2)($32,000)]	16,000
Net Capital Loss Applied Against Current Taxable Capital Gain [(1/2)($32,000)]	(16,000)
Net Capital Loss Applied Against Other Income [(3/4)($54,000 - $32,000)]	(16,500)
Net Inclusion	$44,500

As it is Barton's year of death, the net capital loss can be deducted against any type of income. Note that the carry forward amount must be adjusted for application against current taxable capital gains, but does not require adjustment for application against other types of income.

Exam Exercise Solution Eleven - 9 (ABILs)

The Allowable Business Investment Loss for the year would be calculated as follows:

Actual Loss On Disposition	$47,000
Disallowed By Lifetime Capital Gains Deduction Use	(30,000)
Business Investment Loss	$17,000
Inclusion Rate	1/2
Allowable Business Investment Loss	$ 8,500

All of the $8,500 can be deducted against Mrs. Brown's employment income. With respect to the disallowed $30,000, it becomes an ordinary capital loss, of which $21,000 can be deducted against the current year's capital gains on the publicly traded securities. This leaves a net capital loss carry over of $4,500 [(1/2)($30,000 - $21,000)].

Exam Exercise Solution Eleven - 10 (ABILs)

The Allowable Business Investment Loss for the year would be calculated as follows:

Actual Loss On Disposition	$38,000
Disallowed By Lifetime Capital Gains Deduction Use	(8,000)
Business Investment Loss	$30,000
Inclusion Rate	1/2
Allowable Business Investment Loss	$15,000

The $15,000 can be deducted against Jasmine's employment income. With respect to the disallowed portion of the loss, it becomes a regular capital loss, of which $5,000 can be deducted against the current year capital gain. This will leave a net capital loss carry over of $1,500 [(1/2)($8,000 - $5,000)].

Exam Exercise Solution Eleven - 11 (Farm Losses)

It appears that Bob's farming activities are a subordinate source of income. Given this, the deduction of the 2015 loss would be limited to $13,250 [$2,500 + (1/2)($24,000 - $2,500)]. The remaining $10,750 ($24,000 - $13,250) is a restricted farm loss carry forward.

Bob's 2016 Net Income For Tax Purposes and Taxable Income would be as follows:

Employment Income	$105,000
Farm Income	6,000
Net Income For Tax Purposes	$111,000
Farm Loss (Limited To Farm Income)	(6,000)
Taxable Income	$105,000

This leaves a restricted farm loss carry forward to future years of $4,750 ($10,750 - $6,000).

Exam Exercise Solution Eleven - 12 (Lifetime Capital Gains Deduction)

Ms. Close's maximum lifetime capital gains deduction is the least of the following three items:

Available Deduction Her remaining deduction would be $376,088 [$412,088 - (1/2)($18,000 + $54,000)].

Annual Gains Limit In the absence of capital gains on non-qualified property in any of the years under consideration, the simplified version of this calculation can be used. The annual gains limit for 2016 would be as follows:

Qualified Taxable Capital Gain [(1/2)($748,000)]	$374,000
Net Capital Loss Deducted	(30,000)
Annual Gains Limit	$344,000

Cumulative Gains Limit This amount would be calculated as follows:

Sum Of Annual Gains Limits ($9,000 + $27,000 + $344,000)	$380,000
Previous Years' Capital Gains Deduction ($9,000 + $27,000)	(36,000)
CNIL	(23,000)
Cumulative Gains Limit	$321,000

The least of these three amounts is $321,000, the Cumulative Gains Limit.

Exam Exercise Solution Eleven - 13 (Ordering Of Losses)

Joanne's Net Income For Tax Purposes would be calculated as follows:

Income Under ITA 3(a):		
Employment Income	$61,000	
Business Income	14,200	
Farming Income	2,950	$78,150
Income Under ITA 3(b):		
Taxable Capital Gains		10,500
Net Income For Tax Purposes		$88,650

Joanne's Taxable Income is as follows:

Net Income For Tax Purposes	$88,650
Loss Carry Forwards:	
Restricted Farm Losses (Limited to farming income)	(2,950)
Net Capital Losses (Limited to taxable capital gains)	(10,500)
Non-Capital Losses (All)	(41,000)
Taxable Income	$34,200

Loss Carry Forwards

• Restricted farm loss carry forward ($7,200 - $2,950)	$ 4,250
• Net capital loss carry forward ($25,000 - $10,500)	14,500
• Non-capital loss carry forward	Nil

Exam Exercise Solution Eleven - 14 (Ordering Of Losses)

Cindy's Net Income For Tax Purposes would be calculated as follows:

Income Under ITA 3(a):		
Business Income	$74,000	
Farming Income	2,500	$76,500
Income Under ITA 3(b):		
Taxable Capital Gains		21,000
Net Income For Tax Purposes		$97,500

Cindy's Taxable Income is as follows:

Net Income For Tax Purposes	$97,500
Loss Carry Forwards:	
Restricted Farm Losses (Limited to farming income)	(2,500)
Net Capital Losses (Limited to taxable capital gains)	(21,000)
Non-Capital Losses (All)	(25,000)
Taxable Income	$49,000

Loss Carry Forwards

• Restricted farm loss carry forward ($4,000 - $2,500)	$ 1,500
• Net capital loss carry forward ($32,000 - $21,000)	11,000
• Non-capital loss carry forward	Nil

Exam Exercise Solution Eleven - 15 (Tax On Split Income)

Harriet's regular Tax Payable would be calculated as follows:

Taxable Non-Eligible Dividends [(117%)($13,000)]	$15,210
Modeling Income	13,100
Deduction For Split Income - Non-Eligible Dividends	(15,210)
Net Income For Tax Purposes = Taxable Income	$13,100
Rate	15%
Tax Payable Before Credit	$ 1,965
Basic Personal Credit [(15%)($11,474)]	(1,721)
Regular Tax Payable	$ 244

He tax on split income would be calculated as follows:

Split Income - Taxable Non-Eligible Dividends	$15,210
Rate	33%
Tax Payable Before Dividend Tax Credit	$ 5,019
Dividend Tax Credit [(21/29)(17%)($13,000)]	(1,600)
Tax Payable On Split Income	$ 3,419

Harriet's total tax payable would be $3,663 ($244 + $3,419).

Exam Exercise Solution Eleven - 16 (Transfer Of Dividends To A Spouse)

In the absence of the transfer, Mrs. Senton would have no spousal tax credit. In contrast, with the transfer, she would be eligible for the full $1,721 [(15%)($11,474)]. Given this, the analysis of her position at the federal level would be as follows:

Additional Tax On Dividends [($12,420)(33%)]	$4,099
Spousal Tax Credit	(1,721)
Dividend Tax Credit [(6/11)(38%)($9,000)]	(1,865)
Tax Increase (Decrease)	$ 513

As there is an increase in federal Tax Payable, the election would not be beneficial.

Exam Exercise Solution Eleven - 17 (Donation Of Non-Depreciable Property)

Net Income For Tax Purposes Ms. Wave's gift will result in a taxable capital gain of $55,250 [(1/2)($132,500 - $22,000)]. Her Net Income For Tax Purposes equals $67,750 ($12,500 + $55,250).

Maximum Credit Note that, because Ms. Wave's Taxable Income is less than $200,000, the 33 percent tax rate is not relevant in calculating the charitable donations tax credit. The maximum base for the charitable donations tax credit is calculated as follows:

75% Of Net Income For Tax Purposes [(75%)($67,750)]	$50,813
25% Of Taxable Capital Gain [(25%)($55,250)]	13,813
Charitable Donations Credit Base Limit	$64,626

This base results in a potential credit of $18,714 [(15%)($200) + (29%)($64,626 - $200)].

Credit To Reduce Tax Payable To Nil The credit claim that will reduce Tax Payable to nil is calculated as follows:

Tax On First $45,282	$ 6,792
Tax On Next $22,468 ($67,750 - $45,282) At 20.5%	4,606
Tax Payable Before Credits	$11,398
Basic Personal Credit	(1,721)
Federal Tax Payable Before Donations Credit	$ 9,677

In order to determine the donation that will produce a charitable donations credit of $9,677, the following equation must be solved:

$9,677 = [(15%)($200) + (29%)(X - $200)]

Solving this equation results in a value for X of $33,466. Using this amount of her credit base will result in the required $9,677 [(15%)($200) + (29%)($33,466 - $200)], thereby eliminating her federal Tax Payable.

Carry Forward This will leave a carry forward of $99,034 ($132,500 - $33,466).

Exam Exercise Solution Eleven - 18 (Donation Of Non-Depreciable Property)

Net Income For Tax Purposes Lara's gift will result in a taxable capital gain of $33,000 [(1/2)($84,000 - $18,000)]. Given this, her 2016 Net Income For Tax Purposes equals $56,000 ($23,000 + $33,000).

Maximum Credit Note that, because Lara's Taxable Income is less than $200,000, the 33 percent tax rate is not relevant in calculating the charitable donations tax credit. The maximum base for the charitable donations tax credit is calculated as follows:

75% Of Net Income For Tax Purposes [(75%)($56,000)]	$42,000
25% Of Taxable Capital Gain [(25%)($33,000)]	8,250
Charitable Donations Credit Base Limit	$50,250

This base results in a potential credit of $14,545 [(15%)($200) + (29%)($50,250 - $200)].

Credit To Reduce Tax Payable To Nil The credit claim that will reduce Tax Payable to nil is calculated as follows:

Tax On First $45,282	$6,792
Tax On Next $10,718 ($56,000 - $45,282) At 20.5%	2,197
Tax Payable Before Credits	$8,989
Basic Personal Credit	(1,721)
Federal Tax Payable Before Donations Credit	$7,268

In order to determine the donation that will produce a charitable donations credit of $7,268, the following equation must be solved:

$7,268 = [(15%)($200) + (29%)(X - $200)]

Solving this equation gives a value for X of $25,159. The use of $25,159 of her donation will produce a credit of $7,268 [(15%)($200) + (29%)($25,159 - $200)], an amount sufficient to eliminate her federal Tax Payable.

Carry Forward This will leave a carry forward of $58,841 ($84,000 - $25,159).

Exam Exercise Solution Eleven - 19 (Donation Of Depreciable Property)

Net Income For Tax Purposes Mr. Deveau's Net Income For Tax Purposes can be calculated as follows:

Net Rental Income	$ 8,300
Taxable Capital Gain - Land [(1/2)($86,000 - $34,000)	26,000
Taxable Capital Gain - Building [(1/2)($260,000 - $138,000)]	61,000
Recapture ($138,000 - $43,000)	95,000
Net Income For Tax Purposes	$190,300

Maximum Credit Note that, because Mr. Deveau's Taxable Income is less than $200,000, the 33 percent tax rate is not relevant in calculating the charitable donations tax credit. The maximum base for the charitable donations tax credit is calculated as follows:

75% Of Net Income For Tax Purposes [(75%)($190,300)]	$142,725
25% Of Taxable Capital Gain [(25%)($26,000 + $61,000)]	21,750
25% Of Recapture [(25%)($95,000)]	23,750
Charitable Donations Credit Base Limit	$188,225

This base results in a maximum charitable donations tax credit of $54,557 [(15%)($200) + (29%)($188,225 - $200)].

Credit To Reduce Tax Payable To Nil The credit claim that will reduce Tax Payable to nil is calculated as follows:

Tax On First $140,388	$29,029
Tax On Next $49,912 ($190,300 - $140,388) At 29%	14,474
Tax Payable Before Credits	$43,503
Basic Personal Credit	(1,721)
Federal Tax Payable Before Donations Credit	$41,782

In order to determine the donation that will produce a charitable donations credit of $41,782, the following equation must be solved:

$$\$41,782 = [(15\%)(\$200) + (29\%)(X - \$200)]$$

Solving this equation gives a value for X of $144,172. The use of $144,172 of his donation will produce a credit of $41,782 [(15%)($200) + (29%)($144,172 - $200)], an amount sufficient to eliminate his federal Tax Payable.

Carry Forward This will leave a carry forward of $201,828 ($346,000 - $144,172).

Exam Exercise Solution Eleven - 20 (Donation Of Depreciable Property)

Net Income For Tax Purposes Victor's Net Income For Tax Purposes can be calculated as follows:

Net Rental Income	$16,000
Taxable Capital Gain - Land	Nil
Taxable Capital Gain - Building [(1/2)($346,000 - $176,000)]	85,000
Recapture ($176,000 - $110,000)	66,000
Net Income For Tax Purposes	$167,000

Maximum Credit Note that, because Victor's Taxable Income is less than $200,000, the 33 percent tax rate is not relevant in calculating the charitable donations tax credit. The maximum base for the charitable donations tax credit is calculated as follows:

75% Of Net Income For Tax Purposes [(75%)($167,000)]	$125,250
25% Of Taxable Capital Gain [(25%)($85,000)]	21,250
25% Of Recapture [(25%)($66,000)]	16,500
Charitable Donations Credit Base Limit	$163,000

This base results in a maximum charitable donations tax credit of $47,242 [(15%)($200) + (29%)($163,000 - $200)].

Credit To Reduce Tax Payable To Nil The credit claim that will reduce Tax Payable to nil is calculated as follows:

Tax On First $140,388	$29,029
Tax On Next $26,612 ($167,000 - $140,388) At 29%	7,717
Tax Payable Before Credits	$36,746
Basic Personal Credit	(1,721)
Federal Tax Payable Before Donations Credit	$35,025

In order to determine the donation that will produce a charitable donations credit of $35,025, the following equation must be solved:

$$\$35,025 = [(15\%)(\$200) + (29\%)(X - \$200)]$$

Solving this equation for X gives a value of $120,872. The use of $120,872 of his donation will produce a credit of $35,025 [(15%)($200) + (29%)($120,872 - $200)], an amount sufficient to eliminate his Tax Payable.

Carry Forward This will leave a carry forward of $275,128 ($396,000 - $120,872).

Exam Exercise Solution Eleven - 21 (Foreign Tax Credit)

Mr. Fung's Adjusted Division B Income would be calculated as follows:

Net Income For Tax Purposes	$56,500
Net Capital Loss Deducted	(3,200)
Adjusted Division B Income	$53,300
Non-Capital Loss Carry Forward	(5,000)
Taxable Income	$48,300

His Tax Otherwise Payable would be calculated as follows:

Tax On First $45,282	$6,792
Tax On Next $3,018 ($48,300 - $45,282) At 20.5%	619
Tax Before Credit	$7,411
Basic Personal Credit	(1,721)
Tax Otherwise Payable	$5,690

Mr. Fung's credit for foreign tax paid would be the lesser of the foreign tax withheld of $507 [(13%)($3,900)] and an amount determined by the following formula:

[(Foreign Non-Business Income ÷ Adjusted Division B Income)(Tax Otherwise Payable)]

= [($3,900 ÷ $53,300)($5,690)] = $416

As the amount determined by the formula would be the lesser of the two figures, his foreign tax credit would be $416.

Exam Exercise Solution Eleven - 22 (Foreign Tax Credit)

The total withholding is equal to $900 [(20%)($4,500)] However, because he is an individual, Andy's credit is limited to 15 percent of the non-business income or $675 [(15%)($4,500)]. The remaining $225 ($900 - $675) is available for deduction under ITA 20(11). Given this, Andy's Net Income For Tax Purposes and Taxable Income are calculated as follows:

Net Foreign Non-Business Income ($4,500 - $225)	$ 4,275
Taxable Capital Gain	38,000
Net Income For Tax Purposes	$42,275
Net Capital Loss Carry Forward	(26,000)
Taxable Income = Adjusted Division B Income	$16,275

His adjusted Division B Income is $16,275, the same amount as his Taxable Income.

His Tax Otherwise Payable would be calculated as follows:

Tax Before Credit [(15%)($16,275)]	$2,441
Basic Personal Credit	(1,721)
Tax Otherwise Payable	$ 720

His credit against Tax Payable for foreign tax withheld would be the lesser of $675 [(15%)($4,500)] and an amount determined by the following formula:

[(Foreign Non-Business Income ÷ Adjusted Division B Income)(Tax Otherwise Payable)]

= [($4,500 ÷ $16,275)($720)] = $199

As the amount determined by the formula would be the lesser of the two figures, his foreign tax credit would be $199. This would result in a final figure for Tax Payable of $521 ($720 - $199).

Exam Exercise Solution Eleven - 23 (Alternative Minimum Tax)

Mr. Leigh's regular Tax Payable would be calculated as follows:

$24,288 At 15 Percent	$3,643
Basic Personal Credit	(1,721)
Dividend Tax Credit [(6/11)(38%)($17,600)]	(3,648)
Federal Tax Payable - Regular	Nil

His Adjusted Taxable Income for minimum tax purposes would be calculated as follows:

Regular Taxable Income	$24,288
30 Percent Of Capital Gains [(30%)(2)($120,000)]	72,000
Dividend Gross Up [(38%)($17,600)]	(6,688)
Adjusted Taxable Income	$89,600

The calculation of the alternative minimum tax would be as follows:

Adjusted Taxable Income	$89,600
Basic Exemption	(40,000)
Amount Subject To Tax	$49,600
Rate	15%
Minimum Tax Before Credit	$ 7,440
Basic Personal Credit	(1,721)
Alternative Minimum Tax Payable	$ 5,719

As the alternative minimum tax payable is higher than the regular tax payable, the alternative amount would have to be paid. The $5,719 excess over regular Tax Payable can be carried forward to be applied against any excess of regular tax payable over minimum tax payable in the next seven years.

Exam Exercise Solution Eleven - 24 (Alternative Minimum Tax)

Shelly's regular Tax Payable would be calculated as follows:

$31,740 At 15 Percent	$4,761
Basic Personal Credit	(1,721)
Dividend Tax Credit [(6/11)(38%)($23,000)]	(4,767)
Federal Tax Payable - Regular	Nil

Her Adjusted Taxable Income for minimum tax purposes would be calculated as follows:

Regular Taxable Income	$31,740
30 Percent Of Capital Gains [(30%)(2)($200,000)]	120,000
Dividend Gross Up [(38%)($23,000)]	(8,740)
Adjusted Taxable Income	$143,000

The calculation of the alternative minimum tax would be as follows:

Adjusted Taxable Income	$143,000
Basic Exemption	(40,000)
Amount Subject To Tax	$103,000
Rate	15%
Minimum Tax Before Credit	$ 15,450
Basic Personal Credit	(1,721)
Alternative Minimum Tax Payable	$ 13,729

As the alternative minimum tax payable is higher than the regular tax payable, the alternative amount would have to be paid. The $13,729 excess over regular Tax Payable can be carried forward to be applied against any excess of regular tax payable over minimum tax payable in the next seven years.

TIF Solution Eleven - 5A

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

A. 5

B. 2

C. 7

D. 8

E. 10

F. 1

G. 9

H. 6

The two unused definitions are as follows:

Cumulative Gains Limit = 4

Non-Capital Loss = 3

TIF Solution Eleven - 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. 7

B. 3 (not 14)

C. 10

D. 11 (not 1)

E. 13

F. 2

G. 12 (not 9)

H. 8 (not 5)

The two unused definitions are as follows:

Cumulative Gains Limit = 6

Non-Capital Loss = 4

TIF Solution Eleven - 6

2013 Analysis

The required information can be calculated as follows:

ITA 3(a)		
Property Income	$27,600	
Taxable (Grossed Up) Dividends	3,864	$31,464
ITA 3(b)		
Taxable Capital Gains [(1/2)($1,800)]	$ 900	
Allowable Capital Losses [(1/2)($9,200)]	(4,600)	Nil
ITA 3(c)		$31,464
ITA 3(d)		
Farm Loss (See Note)		(7,350)
Net Income For Tax Purposes And Taxable Income		$24,114

Note Mr. Barkin's farm losses are restricted as follows:

Total Farm Loss		$12,200
Deductible Amount:		
First $2,500	($2,500)	
One-Half Of $9,700 ($12,200 - $2,500)	(4,850)	(7,350)
Restricted Farm Loss Carry Forward		$4,850

As noted in the problem, none of the losses can be carried back before 2013. This would leave the following carry forward balances at the end of 2013:

- Restricted Farm Loss Carry Forward $4,850
- Net Capital Loss Carry Forward ($4,600 - $900) $3,700

2014 Analysis

The required information can be calculated as follows:

ITA 3(a)		
Farm Income	$ 2,320	
Taxable (Grossed Up) Dividends	5,106	$ 7,426
ITA 3(b)		
Taxable Capital Gains [(1/2)($3,000)]	$ 1,500	
Allowable Capital Losses	Nil	1,500
ITA 3(c)		$ 8,926
ITA 3(d)		
Property Loss		(22,250)
Net Income For Tax Purposes		Nil
2013 Net Capital Loss Carry Forward		($ 1,500)
Taxable Income (Loss)		Nil

Since there are taxable capital gains this year, and the problem states that Mr. Barkin would like to deduct the maximum amount of his net capital loss carry forwards, the net capital loss carry forward of $1,500 is added to the balance of the non-capital loss.

The non-capital loss carry over is calculated as follows:

Property Loss	$22,250
2013 Net Capital Loss Deducted	1,500
ITA 3(c) Income	(8,926)
Non-Capital Loss Carry Over For 2014	$14,824

The entire non-capital loss carry over could be carried back to 2013, but since Mr. Barkin requires $18,500 in Taxable Income to fully utilize his tax credits, the maximum carry back to 2013 is $5,614, calculated as follows:

2013 Taxable Income (As Reported)	$24,114
Required 2013 Income For Tax Credits	(18,500)
Maximum Carry Back	$ 5,614

This carry back leaves Mr. Barkin with his required $18,500 in 2013 amended Taxable Income.

There would be the following carry forward balances at the end of 2014:

- Restricted Farm Loss Carry Forward (Unchanged) $4,850
- Net Capital Loss Carry Forward ($3,700 - $1,500)] $2,200
- Non-Capital Loss Carry Forward ($14,824 - $5,614) $9,210

2015 Analysis

The required information can be calculated as follows:

ITA 3(a)		
Property Income	$44,100	
Farm Income	3,840	
Taxable (Grossed Up) Dividends	7,452	$55,392
ITA 3(b)		
Taxable Capital Gains [(1/2)($6,000)]	$3,000	
Allowable Capital Losses	Nil	3,000
Net Income For Tax Purposes		$58,392
Restricted Farm Loss Carry Forward (Equal To Farm Income)		(3,840)
Net Capital Loss Carry Forward (Less Than $3,000)		(2,200)
Non-Capital Loss Carry Forward (All)		(9,210)
Taxable Income		$43,142

There would be the following carry forward balances at the end of 2015:

- Restricted Farm Loss Carry Forward ($4,850 - $3,840) $1,010

2016 Analysis

The required information can be calculated as follows:

ITA 3(a)		
Taxable (Grossed Up) Dividends		$10,902
ITA 3(b)		
Taxable Capital Gains [(1/2)($6,700)]	$ 3,350	
Allowable Capital Losses [(1/2)($21,300)]	(10,650)	Nil
ITA 3(c)		$10,902
ITA 3(d)		
Property Loss	($30,800)	
Farm Loss	(2,400)	(33,200)
Net Income For Tax Purposes And Taxable Income		Nil

The available non-capital loss can be calculated as follows:

Property Loss	$30,800	
Farm Loss (Unrestricted)	2,400	$33,200
ITA 3(c) Income		(10,902)
Non-Capital Loss Carry Over For 2016		$22,298

Although technically, the farm loss is accounted for separately from the non-capital loss, since the farm loss is less than $2,500 it is treated as an unrestricted farm loss and can be applied against all types of income. ITA 31 states that any loss allowed under that provision is considered an unrestricted loss from a farming business for the year for the purposes of calculating the non-capital loss carryover. As a result, the preceding loss carry over of $22,298 is available for carry back to 2015 to be applied against any type of income.

With respect to the net capital loss of $7,300 ($10,650 - $3,350), there are $800 ($3,000 - $2,200) in taxable capital gains left in 2015 as the basis for a carry back. This means that $800 of the 2016 net capital loss can be carried back, leaving $6,500 ($7,300 - $800) to be carried forward as a net capital loss balance.

If both the $22,298 available farm and non-capital loss, as well as the $800 net capital loss were carried back, the amended 2015 Taxable Income would be as follows:

2015 Taxable Income (As Reported)	$43,142
Non-Capital Loss Carry Back From 2016	(22,298)
Net Capital Loss Carry Back From 2016	(800)
2015 Amended Taxable Income	$20,044

This is more than the $18,500 of Taxable Income required to use the 2015 tax credits.

Given these carry backs, the remaining loss carry forwards would be as follows:

- Restricted Farm Loss Carry Forward (Unchanged) $1,010
- Net Capital Loss Carry Forward ($7,300 - $800) $6,500

TIF Solution Eleven - 7

The calculation of Mr. Atkins' Taxable Income for 2015 would be as follows:

Net Rental Income	$36,870
Interest Income	5,250
Net Income For Tax Purposes And Taxable Income	$42,120

In 2016, there is a loss of $210,000 ($275,000 - $65,000) on the common shares. As these were shares in a Canadian controlled private company that used all of its assets to produce active business income, this would be a business investment loss (BIL).

The allowable portion (ABIL) would be $105,000 [(1/2)($210,000)]. In contrast to other types of capital losses, ABILs can be deducted against any source of income.

Based on this analysis, Mr. Atkins' Taxable Income for 2016 would be calculated as follows:

Net Rental Income	$41,200	
Interest Income	5,650	$46,850
Allowable Business Investment Loss		(105,000)
Net Income For Tax Purposes And Taxable Income		Nil

As the ABIL was recognized in 2016, it must first be used to reduce that year's income to nil. Note that, because of this rule, Mr. Atkins cannot deduct a smaller amount in order to have sufficient income to absorb his basic personal tax credit. This will use up $46,850 of the $105,000 total and leave a balance of $58,150 to be carried over to other years.

In carrying this amount back to 2015, the optimum solution would leave $11,327 of Taxable Income so that Mr. Atkins can take advantage of his basic personal tax credit. Note that the calculation of the optimum carry back uses the basic personal amount of the carry back year, not the current year.

This means that Larry will need a loss carry back deduction of $30,793 ($42,120 - $11,327) in 2015. This deduction will leave a Taxable Income of $11,327. As planned, the taxes on this amount will be eliminated by Larry's basic personal credit.

A carry back of $30,793 in 2015 leaves a carry forward balance of $27,357 ($58,150 - $30,793) to be used in future years.

For the next 10 years, the undeducted Allowable Business Investment Loss will be treated as a non-capital loss carry forward that can be deducted against other sources of income. If it has not been utilized within the 10 years, it then becomes a net capital loss carry forward, deductible for an unlimited number of future periods, but only against net taxable capital gains.

TIF Solution Eleven - 8

To the extent that there has been use of the lifetime capital gains deduction in previous years, business investment losses (BILs) are disallowed. When they are disallowed, they become ordinary capital losses that must be deducted against the current year's taxable capital gains. Given this, the non-disallowed portion of the BIL would be calculated as follows:

2016 BIL Realized ($55,000 - $228,000 - $1,000)	$174,000
BIL Disallowed By Previous Use Of ITA 110.6 ($38,000 + $21,000)	(59,000)
Remaining Business Investment Loss	$115,000
Inclusion Rate	1/2
Allowable Business Investment Loss	$ 57,500

Using this analysis, Mr. Barkin's minimum Net Income For Tax Purposes and Taxable Income would be calculated as follows:

Net Employment Income		$115,000
Allowable Business Investment Loss		(57,500)
Net Taxable Capital Gains:		
Taxable Capital Gain		
[(1/2)($328,000 - $153,000 - $2,000)]	$86,500	
Allowable Capital Loss (Disallowed ABIL)		
[(1/2)($59,000)]	(29,500)	57,000
Net Income For Tax Purposes		$114,500
Lifetime Capital Gains Deduction (Note 1)		Nil
Net Capital Loss Carry Forward Deducted (Note 2)		(13,700)
Taxable Income		$100,800

Note 1 As the only capital gains during 2016 are on qualified property, the simplified formula for the annual gains limit can be used. Given this, the lifetime capital gains deduction is nil, the least of:

Amount Available [(1/2)($824,176)]*	$412,088
Amount Used [(1/2)($38,000 + $21,000)]	(29,500)
Amount Available	$382,588

*This is the 2016 limit for gains on dispositions of shares of a qualified small business corporation. For gains on qualified farm or fishing property, the 2016 limit would be $1,000,000.

Taxable Capital Gain On Qualified Property	$86,500
Allowable Capital Loss Deducted (Disallowed ABIL)	(29,500)
ABIL Realized	(57,500)
Annual Gains Limit Prior To Loss Carry Forward	Nil
Net Capital Loss Deducted	(13,700)
Annual Gains Limit	Nil

Sum Of Annual Gains Limits ($19,000 + $10,500 + Nil)	$29,500
Amounts Deducted In Previous Years ($19,000 + $10,500)	(29,500)
CNIL	(4,800)
Cumulative Gains Limit	Nil

Note 2 Even without the deduction of the net capital loss carry forward, the annual gains limit was nil, preventing the deduction of any amount for the lifetime capital gains deduction. Given this, it is appropriate to deduct the net capital loss carry forward.

TIF Solution Eleven - 9

Part A - Taxable Income

Mr. and Mrs. Hanson's Taxable Income would be calculated as follows:

	Mr. Hanson	Mrs. Hanson
Old Age Security Benefits	$ 7,000	$ 7,000
RRIF Income	50,000	Nil
Registered Pension Plan Receipts	25,380	1,680
Dividends Received	800	180
Gross Up On Dividends (38 Percent)	304	68
Interest On Government Bonds	500	4,359
Net Taxable Capital Gain	Nil	Nil
Net Income Before Clawback	$83,984	$13,287
Social Benefits Repayment (See Note)	(1,534)	Nil
Net Income For Tax Purposes And Taxable Income	$82,450	$13,287

Note Mrs. Hanson would not have to repay any of her OAS benefits as her Net Income is well below the threshold income of $73,756. Mr. Hanson's social benefits repayment would be the lesser of:

- $7,000, and
- [(15%)($83,984 - $73,756)] = $1,534.

Part A - Tax Credits

Mr. Hanson cannot take the spousal credit because Mrs. Hanson's Net Income is more than the $11,474 base for this credit. Mrs. Hanson cannot transfer her dividends under ITA 82(3) as the transfer would leave her with Net Income of $13,039 ($13,287 - $180 - $68). This would still be more than the $11,474 base for the spousal credit and, as a consequence, no spousal tax credit would be created. Given these considerations, the amount that can be transferred from Mrs. Hanson to Mr. Hanson is calculated as follows:

Age	$7,125
Pension (On RPP Only)	1,680
Less Excess Of Taxable Income Over Basic Personal Amount ($13,287 - $11,474)	(1,813)
Credit Base Transferred To Spouse	$6,992

Mr. Hanson's maximum tax credits would be as follows:

Basic Personal Amount	$ 11,474
Age $7,125 - [(15%)($82,450 - $35,927)]	147
Pension	2,000
Transfers From Mrs. Hanson (See Preceding)	6,992
Total Base	$20,613
Rate	15%
Total	$ 3,092
Dividend Tax Credit [(6/11)($304)]	166
Charitable Donations [(15%)($200) + (29%)($600 + $200 - $200)]	204
Total Credits	$ 3,462

Charitable donations can be claimed by either spouse, as long as the total donations are less than 75 percent of the claiming spouse's Net Income For Tax Purposes. As Mrs. Hanson has no Tax Payable, Mr. Hanson will claim her charitable donations. It is usually advantageous for one spouse to claim all the charitable donations if they total more than $200, as the low rate of credit is only applied once. Note that because Mr. Hanson's income is less than $200,000, the 33 percent rate is not relevant in calculating the charitable donations tax credit.

Part A - Loss Carry Overs

Mrs. Hanson's net capital loss of $175 [(1/2)($725 - $375)] can be carried back 3 years and forward indefinitely to be claimed against taxable capital gains.

Part B - Pension Income Splitting

The optimum use of pension income splitting would accomplish the following objectives:

- it would permit Mrs. Hanson to claim her dividend tax credit,
- it would permit Mrs. Hanson to fully utilize her pension income tax credit,
- it would eliminate Mr. Hanson's OAS clawback, and
- it would enable both Mr. and Mrs. Hanson to be in the same 20.5 percent tax bracket.

TIF Solution Eleven - 10

Case One

The regular Tax Payable calculation for Serge Lawson would be as follows:

Net Rental Income	$73,100
Eligible Dividends Received	14,000
Gross Up [(38%)($14,000)]	5,320
RRSP Deduction	(22,000)
Net And Taxable Income	$70,420

Tax On First $45,282	$ 6,792
Tax On $25,138 ($70,420 - $45,282) At 20.5 Percent	5,153
Tax Before Credits	$11,945
Basic Personal Credit	(1,721)
Dividend Tax Credit [(6/11)($5,320)]	(2,902)
Regular Federal Tax Payable	$ 7,322

The alternative minimum tax calculations are as follows:

Regular Taxable Income	$70,420
Dividend Gross Up	(5,320)
Adjusted Taxable Income	$65,100
AMT Exemption	(40,000)
AMT Base	$25,100
Rate	15%
Federal AMT Before Credit	$ 3,765
Basic Personal Credit	(1,721)
Federal AMT	$ 2,044

Since the regular federal Tax Payable is greater than the federal AMT, there is no liability for AMT and no related carry forward.

Case Two

The regular Tax Payable calculation for Sarah Bonito would be as follows:

Eligible Dividends	$ 26,000
Gross Up [(38%)($26,000)]	9,880
Net Taxable Capital Gains	263,000
Net Income For Tax Purposes	$298,880
Lifetime Capital Gains Deduction	(260,000)
Taxable Income	$ 38,880

Federal Tax Before Credit [(15%)($38,880)]	$ 5,832
Basic Personal Credit	(1,721)
Dividend Tax Credit [(6/11)($9,880)]	(5,389)
Regular Federal Tax Payable	Nil

The alternative minimum tax calculations are as follows:

Regular Taxable Income	$ 38,880
30 Percent Of Capital Gains [(30%)(2)($263,000)]	157,800
Dividend Gross Up	(9,880)
Adjusted Taxable Income	$ 186,800
AMT Exemptions	(40,000)
AMT Base	$146,800
Rate	15%
Federal AMT Before Credit	$ 22,020
Basic Personal Credit	(1,721)
Federal AMT	$ 20,299

Since the regular federal Tax Payable is nil, the AMT is larger and must be paid. The excess AMT over regular tax payable for Sarah of $20,299 can be carried forward for 7 years and applied against any future excess of regular Tax Payable over the alternative minimum tax.

TIF Solution Eleven - 11

The regular Tax Payable calculations would be as follows:

	Walter	Wendel	Winston
Employment And Business Income	$ 52,100	$42,300	$ 41,300
Eligible Dividends Received	82,300	Nil	12,300
Dividend Gross Up (38 Percent)	31,274	Nil	4,674
Retiring Allowance	Nil	35,000	Nil
RRSP Deduction	Nil	(35,000)	Nil
Taxable Capital Gains	36,400	Nil	226,550
Net Income For Tax Purposes	$202,074	$42,300	$284,824
Lifetime Capital Gains Deduction	(36,400)	Nil	(221,500)
Taxable Income	$165,674	$42,300	$ 63,324
Federal Tax (Note 1)	$ 36,362	$ 6,345	$ 10,491
Basic Personal Credit	(1,721)	(1,721)	(1,721)
Dividend Tax Credit (6/11 of Gross Up)	(17,059)	Nil	(2,549)
Regular Federal Tax Payable	$ 17,582	$ 4,624	$ 6,221

Note 1 The federal tax payable, before the dividend tax credit, is as follows:

	Taxable Income	Federal Tax Calculations	Federal Tax
Walter	$165,674	$29,029 + (29%)($25,286)	$36,362
Wendel	$ 42,300	(15%)($42,300)	$ 6,345
Winston	$ 63,324	$6,792 + (20.5%)($18,042)	$10,491

The alternative minimum tax (AMT) calculations would be as follows:

	Walter	Wendel	Winston
Regular Taxable Income	$165,674	$42,300	$ 63,324
30% Of Capital Gains (Note 2)	21,840	Nil	135,930
Dividend Gross Up	(31,274)	Nil	(4,674)
Adjusted Taxable Income	$156,240	$42,300	$194,580
AMT Exemption	(40,000)	(40,000)	(40,000)
AMT Base	$116,240	$ 2,300	$154,580
Rate	15%	15%	15%
Federal AMT Before Credit	$ 17,436	$ 345	$ 23,187
Basic Personal Credit	(1,721)	(1,721)	(1,721)
Federal AMT	$ 15,715	Nil	$ 21,466
Regular Federal Tax Payable	(17,582)		(6,221)
Additional Tax Required (Note 3)	Nil		$ 15,245

Note 2 The 30 percent capital gain inclusion can be calculated by taking 30 percent of double the taxable capital gain.

Note 3 The excess AMT over regular tax payable for Winston can be carried forward for 7 years and applied against any future excess of regular Tax Payable over the alternative minimum tax.

TIF Solution Eleven - 12

The various components of Mr. Bronson's Net Income For Tax Purposes would be calculated as follows:

Pension Income

RPP Receipts	$83,000
Canada Pension Plan Receipts	10,680
Pension Income	$93,680

Land Sales (Note 1)

Capital Gain On Plot A ($150,000 - $125,000)	$ 25,000
Capital Gain On Plot B ($250,000 - $175,000)	75,000
Total Capital Gain	$100,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 50,000

Note 1 As these are non-arm's length sales, ITA 69 is applicable. Plot A was sold below fair market value and, because of this, the proceeds would be deemed to be the fair market value of $150,000. Note that Phil's adjusted cost base would be limited to the $50,000 that was paid. Since the note was paid during 2016, there is no capital gains reserve available. Plot B was sold at a value in excess of fair market value and, in this case, ITA 69 indicates that the sale price will be the proceeds of disposition. Note that Gary's adjusted cost base would be the $210,000 fair market value.

YP Real Estate Income Trust Units (Note 2)

Income Distribution [(1)($800) + (11)($800)]	$ 9,600

Capital Gain ($310,000 - $300,000)	$10,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 5,000

Note 2 As Brenda is under 18 years of age, all of the income on the trust units that is paid to her ($8,800) would be attributed back to Mr. Bronson. The income attribution will stop when Mr. Bronson dies. As there is no rollover provision with respect to transfers to a minor, Mr. Bronson must transfer the units at fair market value and will have to pay taxes on the taxable capital gain resulting from the gift to Brenda. If Brenda had sold the units while he was alive, there would have been no attribution of capital gains.

Gift Of Baron Inc. Shares

Proceeds Of Disposition (Note 3)	$294,000
Adjusted Cost Base [(4,500)($60)]	(270,000)
Capital Gain	$ 24,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 12,000

Note 3 The adjusted cost base of the Baron Inc. shares would be their average cost, determined as follows:

1st Purchase (4,000 Shares @ $50)	$200,000
2nd Purchase (8,000 Shares @ $65)	520,000
Total Cost	$720,000

Based on this cost, the average cost of the shares is $60 ($720,000 ÷ 12,000) per share.

Since the problem requires the minimum Net Income For Tax Purposes, Mr. Bronson will not elect out of the ITA 73(1) rollover. As a result, the 1,500 shares given to his spouse will be transferred at their adjusted cost base. In contrast, the proceeds of disposition for the shares gifted to his children would be their fair market value of $68 per share. Given this, the proceeds of disposition would be calculated as follows:

1,500 Shares @ $60	$ 90,000
3,000 Shares @ $68	204,000
Total Proceeds Of Disposition	$294,000

Dividends On Baron Inc. Shares

Dividends Received And Attributed Back (Note 4)	$13,500
Gross Up Of 38 Percent	5,130
Taxable Dividends	$18,630

Note 4 The dividends on the 1,500 shares gifted to Melissa would be attributed back to Mr. Bronson. The dividends on the shares gifted to his (adult) children will be taxed in their hands. Since he is holding 7,500 shares on July 1, the dividends he will be taxed on for the year total $13,500 [(1,500 + 7,500)($1.50)].

Condominium Units Immediately before the time of Mr. Bronson's death, there is a deemed disposition of all of his capital property. If the beneficiary is a spouse, the deemed proceeds of disposition are equal to the tax cost of the property (UCC in this case). This means that the unit transferred to Melissa will be transferred at its tax cost of $205,000. She will, however, retain the original capital cost of $300,000, with the difference being deemed CCA.

For the transfers to the children, the transfer will be deemed to take place at the $420,000 fair market value figure. That will result in following tax consequences for Mr. Bronson:

Proceeds Of Disposition [(2)($420,000)]	$840,000
Capital Cost [(2)($300,000)]	600,000
Capital Gain	$240,000
Inclusion Rate	1/2
Taxable Capital Gain	$120,000

Capital Cost [(2)($300,000)]	$600,000
UCC [(2)($205,000)]	(410,000)
Recapture	$190,000

In addition to the taxable capital gain and recapture, the properties earned $93,750 of net rental income prior to Mr. Bronson's death.

Other Properties At Death

Baron Inc. Shares At the time of his death, Mr. Baron owns the 7,500 remaining shares of Baron Inc. As these are transferred to his spouse, the deemed proceeds will be equal to the tax cost of the shares and there will be no 2016 tax consequences.

Principal Residence As with the Baron Inc. shares, the property can be transferred to Melissa at its tax value. Alternatively, the executor could elect to transfer it at fair market value and use the principal residence gain reduction formula to eliminate the $417,000 capital gain. In either case, there are no tax consequences for Mr. Bronson.

Part A - Net Income For Tax Purposes And Taxable Income

Mr. Bronson's minimum Net Income For Tax Purposes and Taxable Income would be calculated as follows:

Pension Income		$ 93,680
Income Trust Distribution		9,600
Taxable Dividends		18,630
Net Rental Income		93,750
Recapture		190,000
Taxable Capital Gains:		
On Land	$ 50,000	
On Trust Units	5,000	
On Gift Of Baron Inc. Shares	12,000	
On Condominium Units	120,000	187,000
Net Income For Tax Purposes		$592,660
Net Capital Loss Carry Forward		(30,000)
Taxable Income		$562,660

Part A - Tax Payable

Mr. Bronson's minimum federal Tax Payable would be calculated as follows:

Tax On First $200,000		$ 46,317
Tax On Next $362,660 ($562,660 - $200,000) At 33 Percent		119,678
Tax Before Credits		$165,995
Tax Credits:		
Basic Personal	($11,474)	
Spousal Including FCA	(13,595)	
Age (Income Too High)	Nil	
Pension Income	(2,000)	
Spouse's Disability	(8,001)	
Medical Expenses (Note 5)	(54,763)	
Total Credit Base	($89,833)	
Rate	15%	(13,475)
Dividend Tax Credit [(6/11)($5,130)]		(2,798)
Federal Tax Payable		$149,722

Note 5 The base for the medical expenses tax credit would be the total medical costs of $57,000 ($45,000 + $12,000), reduced by the lesser of $17,780 [(3%)($592,660)] and $2,237.

Part B - Pension Splitting Tax Savings

If the pension splitting of Mr. Bronson's RPP payments is for $41,500, it will increase Melissa's income by $41,500 and decrease Wally's by the same amount. Melissa's federal Tax Payable and Wally's net tax savings will be as follows:

Tax Before Credits [(15%)($41,500)]		$6,225
Basic Personal	($11,474)	
Disability	(8,001)	
Pension (Not Previously Available)	(2,000)	
Total Credit Base	($21,475)	
Rate	15%	(3,221)
Melissa's Federal Tax Payable		$3,004

Wally's Tax Saving [(33%)($41,500)]		$13,695
Spousal Credit Including FCA Lost	($13,595)	
Disability Credit Taken By Melissa	(8,001)	
Total Credits Lost	($21,596)	
Rate	15%	(3,239)
Wally's Net Tax Savings		$10,456

With pension income splitting, the total federal tax savings amount to $7,452 ($10,456 - $3,004). Further savings would be available at the provincial level.

Note that the total medical expenses are much greater than Melissa's income. As a result, although Melissa could claim a larger medical expense credit given her lower Net Income, she could not fully utilize that credit, so it remains on Wally's return.

TIF Solution Eleven - 13

Part A

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

Salary	$58,000
Housing Benefit (12 Months At $1,000)	36,000
Less: Rents Paid	(12,000)
Award	2,100
Director's Fees	1,300
Stock Option Benefits [(100)($16 - $7)]	900
Net Employment Income	$86,300

Part B

Since Mr. Leonard's son is over 17 years of age, the interest on the bonds is not attributed to Mr. Leonard. Mr. Leonard's income from property would be calculated as follows:

Royalties On Patent	$24,070
Interest On Bonds	430
Income From Property	$24,500

Part C

Mr. Leonard's net taxable capital gains would be calculated as follows:

Listed Personal Property:			
Proceeds From Ring	$1,200		
Deemed Cost	(1,000)	$ 200	
Proceeds From Painting	$1,100		
Cost	(1,800)	(700)	Nil
Personal Use Property:			
Proceeds From Pistols		$2,000	
Cost		(1,400)	
Capital Gain		$ 600	
Inclusion Rate		1/2	$300
Net Taxable Capital Gains			$300

The preceding calculations indicate that Mr. Leonard would be left with a listed personal property loss of $250 [(1/2)($200 - $700)]. This unused loss can be carried back three years and forward for seven years, but it can only be deducted against taxable capital gains on listed personal property.

Part D

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

Employment Income	$ 86,300
Income From Property	24,500
Taxable Capital Gain	300
RRSP Contribution (See Note)	(15,534)
Net Income For Tax Purposes	$95,566

Note Mr. Leonard's RRSP Deduction Limit for 2016 is the lesser of $25,370 and 18 percent of his 2015 Earned Income. His Earned Income for 2015 is assumed to be equal to his 2016 Earned Income. The only item in his 2016 Earned Income is his Net Employment Income of $86,300. Eighteen percent of this amount is $15,534, less than the $25,370 RRSP deduction limit for the year.

As there is no PA to take into consideration and he has contributed $16,000, his maximum deduction will be $15,534.

Part E

Mr. Leonard's Taxable Income would be calculated as follows:

Net Income For Tax Purposes	$95,566
Stock Option Deduction [(1/2)($900)]	(450)
Taxable Income	$95,116

Part F

Mr. Leonard's federal Tax Payable would be calculated as follows:

Federal Tax On First $90,563		$16,075
Federal Tax On Next $4,553 ($95,116 - $90,563) At 26 Percent		1,184
Gross Federal Tax		$17,259
Tax Credits:		
Basic Personal Amount	($11,474)	
Spousal ($11,474 - $2,990)	(8,484)	
CPP	(2,544)	
EI	(955)	
Canada Employment	(1,161)	
Transfer Of Son's Tuition, Education And Textbook		
- Lesser Of (See Note):		
• $5,000		
• [$3,000 + (4)($400) + (4)($65)] = $4,860	(4,860)	
Credit Base	($29,478)	
Rate	15%	(4,422)
Federal Tax Payable		$12,837

Note As his son's income is $3,700 [(12)$250) + $700], he will have no Tax Payable and Mr. Leonard will be able to take the full credit. There is no credit for his aunt because she is not a resident of Canada.

TIF Solution Eleven - 14

Part A - Taxable Income

Daniel Tong's employment income would be calculated as follows:

Inclusions:		
Salary	$78,000	
2015 Bonus (Cash Basis)	6,000	
Home Office Allowance	2,400	
Standby Charge - No Reduction [($5,200)(2/3)]	3,467	
Automobile Operating Benefit [(14,000 km)($0.26)]	3,640	
Group Term Life Insurance Premium	650	
Dental Insurance	Nil	
Stock Option Benefit [(2,500)($15 - $12)]	7,500	$101,657
Deductions:		
Company Pension Contributions	($ 3,900)	
Home Office [(30/300)($2,100 + $750)]	(285)	
Office Supplies	(230)	(4,415)
Net Employment Income		$ 97,242

Notes

- In general, the only home office costs that can be deducted are utilities and maintenance. In the case of employees with commission income, a pro rata share of insurance and property taxes would also be deductible. However, it does not appear that Mr. Tong has any commission income.
- As the only capital costs that are deductible by an employee are those related to an automobile, aircraft, or musical instrument, the cost of the computer and peripherals are not deductible.
- The use of employment related frequent flyer points is not considered a taxable benefit by the CRA.

Mr. Tong's Net Income For Tax Purposes and Taxable Income would be calculated as follows:

Net Employment Income (See Preceding)		$ 97,242
Business Income - Sale Of Automobile		
[$14,500 - ($2,500 + $8,100)]		3,900
Property Income:		
Portus Dividends Received	$4,500	
Gross Up [(38%)($4,500)]	1,710	
Less Interest Expense	(1,200)	5,010
Spousal RRSP Withdrawal (Attributed To Mr. Tong)		1,000
Net Taxable Capital Gain:		
Taxable Capital Gain On Portus Shares (Note 1)	$3,581	
Allowable Capital Loss On Global Shares (Note 2)	Nil	3,581
RRSP Contribution (Note 3)		(10,200)
Net Income For Tax Purposes		$100,533
Stock Option Benefit [(1/2)($7,500)]		(3,750)
Net Capital Loss Carry Forward (Note 4)		(3,581)
Taxable Income		$ 93,202

Note 1 For shares acquired through the exercise of stock options, the adjusted cost base is the fair market value of the shares at the time of exercise. Based on this, the average cost of his Portus Ltd. shares is calculated as follows:

2,500 Shares At $15	$37,500
250 Shares At $18	4,500
Total Adjusted Cost Base	$42,000

Based on this total, the average cost per share is $15.27 ($42,000 ÷ 2,750). Using this figure, the taxable capital gain would be calculated as follows:

Proceeds [(1,250)($21)]	$26,250
Adjusted Cost Base [(1,250)($15.27)]	(19,088)
Capital Gain	$ 7,162
Inclusion Rate	1/2
Taxable Capital Gain	$ 3,581

Note 2 The $2,400 loss ($8,600 - $11,000) is deemed to be superficial, as Mr. Tong repurchased more than 800 Global shares within 30 days of the original disposition. This means that the loss will be disallowed. However, it will be added to the adjusted cost base of the replacement shares, giving a total adjusted cost base of $8,200 ($5,800 + $2,400).

Note 3 Mr. Tong's 2016 RRSP deduction room would be calculated as follows:

Lesser Of:	
2016 RRSP Limit = $25,370	
18% Of $61,500 = $11,070	$11,070
2015 Pension Adjustment	Nil
Total 2016 Deduction Room	$11,070

While he has $11,070 in deduction room, his actual deduction is limited to $10,200, his $2,200 in undeducted contributions from the beginning of the year, plus his $8,000 contribution to his wife's RRSP.

Note 4 Mr. Tong has a net capital loss balance of $11,500 ($2,500 + $6,000 + $3,000). However, the amount that can be deducted is limited to the 2016 taxable capital gain, or $3,581. This will leave a net capital loss balance of $7,919 ($11,500 - $3,581).

Part B - Tax Payable

Mr. Tong's minimum federal Tax Payable is calculated as follows:

Tax On First $90,563		$16,075
Tax On Next $2,639 ($93,202 - $90,563) At 26 Percent		686
Gross Federal Tax		$16,761
Basic Personal Amount	($11,474)	
Spousal ($11,474 - $360)	(11,114)	
CPP	(2,544)	
EI	(955)	
Canada Employment	(1,161)	
Transfer Of Education Related Amounts (Note 5)	(5,000)	
Credit Base	($32,248)	
Rate	15%	(4,837)
Dividend Tax Credit [(6/11)(38%)($4,500)]		(933)
Federal Tax Payable		$10,991

Note 5 Marion's federal Tax Payable is nil as the scholarship is not taxable income.

Interest Income	$ 3,000
Scholarship ($10,000 - $10,000)	Nil
Taxable Income	$ 3,000
Basic Personal Amount	(11,474)
Federal Tax Payable	Nil

As Marion is unable to use her education related credits, a portion can be transferred to her father. The transfer is the lesser of:

- $5,000
- [$7,150 + (8)($400) + (8)($65)] = $10,870

Given this, the maximum transfer is $5,000. However, the $5,870 ($10,870 - $5,000) excess can be carried forward indefinitely to be used against Marion's future Tax Payable.

Part B - Carry Forwards

- From Note 4, there is a net capital loss of $7,919 available for carry forward to subsequent years.
- From Note 5, Marion has a $5,870 education related credit amount available for carry forward to subsequent years.

Chapter Twelve Test Item File Solutions

TIF Solution Twelve - 1

1. The required three items can be selected from the list presented in Figure 12-1 of the text. These items are:

    - Income tax expense
    - Amortization, depreciation, and depletion of tangible and intangible assets (accounting amounts)
    - Recapture of CCA
    - Tax reserves deducted in the prior year
    - Losses on the disposition of capital assets (accounting amounts)
    - Pension expense (accounting amounts)
    - Scientific research expenditures (Accounting amounts)
    - Warranty expense (accounting amounts)
    - Amortization of discount on long-term debt issued (see discussion in Chapter 7)
    - Foreign tax paid (accounting amounts)
    - Excess of taxable capital gains over allowable capital losses
    - Interest and penalties on income tax assessments
    - Non-deductible automobile costs
    - 50 percent of business meals and entertainment expenses
    - Club dues and cost of recreational facilities
    - Non-deductible reserves (accounting amounts)
    - Charitable donations
    - Asset write-downs including impairment losses on intangibles
    - Fines, penalties, and illegal payments

2. The required items can be selected from the following list:

    - employee stock option deduction
    - deduction for payments (social assistance and workers' compensation benefits)
    - home relocation loan deduction
    - lump-sum payments
    - lifetime capital gains deduction
    - northern residents deductions

3. A corporation does not get a tax deduction for dividends paid. As a consequence, dividends are paid out of the corporation's after tax income. When such dividends are received by an individual, they are subject to taxation (the gross up and tax credit procedures result in dividends being taxed at favourable rates).

    However, if a corporation had to pay taxes on dividends received out of the after tax income of another corporation, it would involve double taxation of the same income stream. In fact, if the income passed through more than one corporation, the result could be triple or even higher multiples of taxation. This would clearly not be an equitable situation and, as a consequence, a corporation is generally not required to pay taxes on dividends received from another taxable Canadian corporation.

4. The stop loss rules reflect the fact that the value of shares usually falls when dividends are paid. Further, the payment of such dividends is, in general, fairly predictable. Given this, a corporation could acquire shares in anticipation of receiving a dividend payment. As dividend payments to corporations are, in general, not subject to tax, this dividend payment could be received tax free. Provided the value of the shares falls after the dividend payment, the corporation could then sell the shares at a loss. The net result would be the receipt of tax free income, combined with a deductible loss for a similar amount.

   As this is not an appropriate result, the stop loss rules will disallow the loss if:

   - the shares are held for less than one year; or
   - if the corporation holding the shares, along with other non-arm's length persons, owns more than 5 percent of the class of shares on which the dividend was received.

5. For corporations, charitable donations are a deduction in the calculation of Taxable Income. In contrast, charitable donations made by an individual form the basis for a credit against Tax Payable. Note, however, that the other rules associated with contributions are the same for corporations and individuals (e.g., they can only be used to the extent of 75 percent of Net Income For Tax Purposes and unused amounts can be carried forward for 5 years).

6. For corporations, dividends received are included in Net Income For Tax Purposes, but deducted in the determination of Taxable Income. If business or property losses are sufficient to reduce the amount of income recorded in ITA 3(a) and 3(b) to less than the amount of dividends included in Net Income For Tax Purposes, the result could be all or part of such dividends being subject to tax. This is avoided by defining Non-Capital Loss in a manner that includes any dividends received that cannot be deducted during the current year.

7. ITA 111(3) requires that losses within any single category must be deducted in chronological order. That is, if a corporation chooses to deduct a portion of its non-capital loss balance during the current year, the oldest losses of this type must be deducted first. However, there are no rules with respect to the order in which the individual types of loss carry forwards must be deducted.

   In deciding which loss should be deducted first, management must evaluate which type of loss is more likely to be lost or can be used more quickly. Non-capital loss carry forwards have restrictions on the time for which they are available. If there are losses that are nearing the end of their carry forward period and there is uncertainty of whether there will be sufficient income in that period to be able to use the losses, these losses should be deducted first.

   While there is no restriction on the period of availability for net capital loss carry forwards, these amounts can only be used to the extent that there are net taxable capital gains during the period. For a corporation that experiences only limited or unpredictable capital gains, these restrictions may be a more important consideration than the period of time during which the loss will be available as the carry forward period for non-capital losses is 20 years.

   A decision will have to be made on the basis of considerations such as these.

8. Provincial taxes are paid in provinces where the corporation has permanent establishments. The amount allocated to each province is based on the simple average of two percentages — the percentage of sales in the province and the percentage of wages and salaries paid in the province.

9. The 10 percent federal tax abatement is only fully available on income that is allocated to a Canadian province. If, for example, only 80 percent of Taxable Income was allocated to a Canadian province, the 10 percent abatement would only apply to 80 percent of Taxable Income.

10. The required two goals and related examples can be selected from the ones in the text. These are as follows:

    - **Incentives For Small Business** While there are several features of the tax system directed at encouraging small businesses, the major tax incentive for these organizations is the small business deduction.
    - **Incentives For Certain Business Activities** The Canadian tax system encourages scientific research through a generous system of tax credits and a liberal policy towards deductible amounts. Tax credits are available to encourage business activities such as the employment of apprentices and the creation of child care spaces. Support is also provided to the natural resource industries through a variety of programs.
    - **Incentives For Certain Regions** Certain regions of Canada are given assistance through investment tax credits and other programs.
    - **Integration** One of the goals of the Canadian tax system is to keep the level of taxes paid on a given stream of income the same, regardless of whether or not a corporation is placed between the original source of the income and the ultimate recipient. The dividend gross up and tax credit procedures are in place to improve integration.

11. The general conditions are as follows:

    - The corporation must be a Canadian controlled private corporation.
    - The income must be active business income.
    - The amount of the income cannot exceed $500,000.
    - The $500,000 limit must be shared by associated corporations.

12. A specified investment business is a business carried on by a corporation, the principal purpose of which is to earn property income, but does not include a corporation that employs more than five full time employees in the business throughout the year.

    The problem that was resolved by this definition was that, while the government did not want to make the small business deduction available to individuals attempting to simply shelter income earned by their investments, it did recognize that it was possible to have a business that was "actively" engaged in earning property income. The specified investment business definition provided a clear, though somewhat arbitrary, criteria for identifying such businesses.

13. Interest income will be considered to be active business income in the following circumstances:

    - The income is earned by a CCPC with more than 5 full time employees and its principal business is producing property income.
    - The interest results from the investment of temporary cash balances associated with fluctuations in producing active business income.
    - The interest received has been deducted by another CCPC in its determination of active business income.

14. This limitation is included in order to ensure that these deductions are not given on amounts of income that have not been taxed. Amounts of active business income and/or M&P profits that have been included in Net Income For Tax Purposes may be eliminated by either charitable donations or non-capital loss carry forwards, resulting in their not being included in Taxable Income and not being subject to tax.

15. This reduction is made in order to eliminate the amount of foreign business income on which the foreign tax credit has eliminated all of the Canadian taxation. The 4 times figure is based on the assumption that the corporation's tax rate is 25 percent (1 ÷ 4) on this type of income.

16. The policy goal of the small business deduction is to assist small businesses. Unfortunately, because the basic provisions of this legislation are based on the type of corporation and the type of income, the deduction could be available to many large corporations. To deal with this, ITA 125(5.1) requires the annual business limit to be reduced based on Taxable Capital Employed In Canada. Because this is a measure of the corporation or the associated group of companies' size, it effectively prevents very large corporations from benefitting from the small business deduction.

17. The formal definition of a personal services business is as follows:

    ... a business of providing services where

    (a) an individual who performs services on behalf of the corporation (referred to as an incorporated employee), or
    (b) any person related to the incorporated employee

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

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

    With respect to special tax features, personal services businesses are not eligible for the small business deduction. In addition, no deduction is permitted to the corporation for any expenses other than:

    - salaries, wages, other remuneration, and benefits paid in the year to the individual who performed the services on behalf of the corporation; and
    - other expenses that would normally be deductible against employment income, for example, travel expenses incurred to earn employment income.

18. The M&P deduction is no longer important in the determination of federal Tax Payable as the rate for this deduction is identical to that used in the general rate reduction. While income that is eligible for the M&P deduction can be used for the general rate reduction, the taxpayer cannot use both. As the rate is the same for each of these tax preferences, there is little point in bothering to determine M&P profits at the federal level.

    However, the legislation has not been eliminated because some provinces still provide special treatment for M&P profits. More specifically, Newfoundland, Ontario and Saskatchewan have reduced rates for this type of income.

19. The calculation of the general rate reduction would begin by determining the CCPC's Taxable Income and deducting from that:

    - income eligible for the small business deduction; and
    - income eligible for the M&P deduction.

    The resulting full rate taxable income would be multiplied by 13 percent to calculate the general rate reduction.

20. The "tax otherwise payable" calculation is to ensure that any foreign tax credit does not exceed a proportionate share of Canadian taxes paid on the foreign income. Foreign business income is not earned in a province and, as a consequence, there will be no applicable provincial taxes. As the ITA 124(1) abatement was put in place to leave room for provincial taxes, it would not be appropriate to deduct this amount in determining "tax otherwise payable", which serves as a limiting factor for the foreign business income tax credit.

TIF Solution Twelve - 2

New For 2016/2017

1. False. Corporations deduct their charitable donations in the determination of Taxable Income.

2. True. Only individuals and trusts use the dividend gross up and tax credit procedures.

3. True. Such dividends are included in the E component of the non-capital loss calculations.

4. False. The fact that net capital losses can only be applied against taxable capital gains may make it more appropriate to deduct these losses first.

5. False. Full Rate Taxable Income does not include income that is eligible for the manufacturing and processing deduction.

6. True. If a corporation's ownership of rental units was so extensive as to constitute a business (e.g., a hotel chain with 10,000 rooms), the rental income would be considered active business income.

7. False. If a business earning property income employs more than 5 full time individuals, it is not a Specified Investment Business.

8. True. Not only does the corporation lose access to the small business deduction, the deductions for the corporation are limited to salaries, wages, and other expenses that would normally be deductible against employment income.

9. False. CCPCs may have income that it not eligible for the small business deduction (e.g., active business income in excess of $500,000). Active business income that is not eligible for the small business deduction would be considered Full Rate Taxable Income and would be eligible for the General Rate Reduction provision.

10. True. Taxes paid on foreign source business income not used during the current year can be carried back to the 3 preceding taxation years and forward to the 10 subsequent taxation years.

Retained From Previous Editions

11. True. The carry forward rules are the same for corporations and individuals.

12. True. While there is no requirement that non-capital losses be deducted prior to other types of losses, ITA 111(3) requires that a given type be deducted in the order in which the losses were incurred.

13. False. The base used for calculating the M&P deduction is reduced by the amount that is eligible for the small business deduction, not by the amount of the small business deduction.

14. False. This rule applies to individuals but not to corporations.

15. True. A corporation's Net Income For Tax Purposes includes the full amount of any foreign non-business income, without regard to the amount of taxes withheld in the foreign venue.

TIF Solution Twelve - 3

New For 2016/2017

1. A. A deduction of $28,000 [removes accounting gain of $28,000 ($130,000 - $112,000)], an addition of $5,000 [adds taxable capital gain of $5,000 (1/2)($140,000 - $130,000)], and an addition of $34,000 [adds recapture of $34,000 ($130,000 - $96,000)].

2. D. The correct amount is calculated as follows:

Amount E		
Business Loss	$375,000	
Allowable Business Investment Loss	23,000	
Dividends Received	53,000	$451,000
Amount F		
Net Taxable Capital Gains	($67,000)	
Dividends Received	(53,000)	(120,000)
Non-Capital Loss For The Year		$331,000

3. B. The federal tax abatement is always equal to 10 percent of corporate Tax Payable.

4. C. $231,000 ($223,000 + $8,000)

5. B. A Specified Investment Company is a Canadian controlled private corporation whose primary purpose is earning property income and it has less than 5 full-time employees.

6. C. $15,210

The base for the small business deduction is limited to the annual business limit of $500,000. Given this, the M&P deduction would be equal to 13 percent of the lesser of:

M&P Profits	$617,000
Amount Eligible For the Small Business Deduction	(500,000)
	$117,000

Taxable Income	$788,000
Amount Eligible For The Small Business Deduction	(500,000)
Aggregate Investment Income	(65,000)
	$223,000

The deduction would be $15,210 [(13%)($117,000)].

7. B. $18,330 (13%)($396,000 - ($35,875 ÷ 17.5%) - ($6,500 ÷ 13%)]

8. B. Any amount of a corporation's foreign non-business tax credit in excess of 15 percent of foreign non-business income must be deducted in determining Net Income For Tax Purposes.

Retained From Previous Editions

9. D. Included in Net Income For Tax Purposes, but not in Taxable Income.

10. C. They are a deduction in the determination of corporate Taxable Income but not in the determination of corporate Net Income.

11. C. The lifetime capital gains deduction.

12. A. Net Income for Tax Purposes - $105,500; Taxable Income - $51,000.
Net Income for Tax Purposes = $76,000 + (1/2)($38,000) + $69,000 + $2,500 – $61,000 = $105,500;
Taxable Income = $105,500 - $2,500 - $52,000 = $51,000.

13. B. $3,750 [(20%)(15,000)($29 - $32.50) - (20%)(15,000)($2.25)]. The stop loss rules apply as Victoria owns over 5% of the shares of Vancouver, and also because the shares were held for less than one year.

14. B. Net Income For Tax Purposes = $91,000 + $10,000 - $84,000 = $17,000
$17,000 × 75% = $12,750

15. B. Gross revenue and salaries and wages paid by the establishment.

16. D. 71.57% (100% - 28.43%)
Foreign percentage = {[1/2][($4,500,000/$13,500,000) + ($2,000,000/$8,500,000)]} = 28.43%

17. D. Full rate taxable income includes any income that is not eligible for the small business deduction.

18. A. Public and private corporations are eligible for the general rate reduction.

19. C. The provincial systems use a rate structure similar to the federal system for corporations and, except for Alberta and Quebec, the calculation of taxable income is the same as that used federally.

20. E. None of the above.

21. E. Both A and C.

22. B. The small business deduction is calculated as the least of three figures:

Net Income For Tax Purposes	$185,000
Taxable Capital Gain	(2,000)
Village's Active Business Income	$ 183,000

Net Income For Tax Purposes	$185,000
Charitable Donations	(2,500)
Village's Taxable Income	$182,500

Annual Business Limit	$500,000
Allocation To Bob's	(116,500)
Business Limit	$383,500

Therefore, the small business deduction is $31,938 [($182,500)(17.5%)].

23. A. A business which principally derives its income from rental property and has less than 5 full-time employees.

24. B. A branch of Moose Jaw Corporation invests surplus cash for 2-3 months every year earning interest income which is less than 1% of corporate income.

25. D. $400,000 [($500,000)(0.225%)($14,000,000-$10,000,000) ÷ $11,250]

26. C. $17,500
{17.5%} {$500,000 - [($500,000)(0.225%)($14,000,000-$10,000,000) ÷ $11,250]}

27. C. The company would be able to deduct the salary paid to Ammar, any benefits paid on his behalf, and any other expenses that would be normally be deductible against employment income. (This is a personal services corporation, and these are the only expenses it will be permitted to deduct.)

28. B. [(17.5%)($145,500)] = $25,463

29. A. Donald Dorsey is not a Canadian resident throughout the year.

30. C. Personal services business income

31. A. The manufacturing and processing deduction is available to any corporation that has manufacturing and processing profits. M&P has to be 10 percent or more of Canadian active business income.

32. C. The general rate reduction is not available to Canadian Controlled Private Corporations (CCPCs).

33. C. $30,175 [(38%)($250,000) – (10%)(87%)($250,000) – (17.5%)($235,000) – (13%)($250,000 - $235,000)]

34. B. In the formula that limits this credit, the Tax Otherwise Payable is reduced by the federal tax abatement.

35. D. $ 211,000 [$246,000 - $5,000 - $30,000]

36. C. $ 46,500 [$48,000 - $1,500]

TIF Solution Twelve - 4

Exam Exercise Solution Twelve - 1 (Schedule 1 Reconciliation)

Item 1 You would deduct the accounting gain of $66,600 ($93,000 - $26,400). You would also add the taxable capital gain of $1,850 [(1/2)($93,000 - $89,300)], for a net deduction of $64,750.

Item 2 You would add the estimated warranty costs of $22,000.

Item 3 As goodwill is not amortized for accounting purposes and there was no impairment during the year, no adjustment of the accounting figures is required. However, when the goodwill is added to the CEC balance, it would be subject to amortization at a rate of 7 percent per year. This means that you would deduct CEC amortization of $3,570 [($68,000)(3/4)(7%)].

Item 4 You would add the discount amortization of $2,300.

Exam Exercise Solution Twelve - 2 (Schedule 1 Reconciliation)

Item 1 You would deduct the premium amortization of $5,600.

Item 2 You would add the accounting amortization of $1,600, and deduct the full cost of $16,000 for tax purposes.

Item 3 You would deduct the accounting gain of $60,000 ($145,000 - $85,000), add the taxable capital gain of $12,500 [(1/2)($145,000 - $120,000)], and add the recapture of CCA of $15,000 ($105,000 - $120,000).

Item 4 You would add the $4,500 of interest charged on late tax instalments.

Exam Exercise Solution Twelve - 3 (Corporate Taxable Income)

Net Income For Tax Purposes	$275,000
Dividends Received	(15,600)
Charitable Donations	(9,100)
Non-Capital Loss Carry Forward (All)	(74,000)
Net Capital Loss Carry Forward*	(13,720)
Taxable Income	$162,580

*While there is a $20,000 net capital loss available, the actual deduction is limited to the current year's taxable capital gains of $13,720. The remaining net capital loss carry forward is $6,280 ($20,000 - $13,720).

Exam Exercise Solution Twelve - 4 (Corporate Taxable Income)

Net Income For Tax Purposes	$472,000
Dividends Received	(22,000)
Charitable Donations	(14,500)
Non-Capital Loss Carry Forward (All)	(102,000)
Net Capital Loss Carry Forward*	(12,400)
Taxable Income	$321,100

*While there is a $56,000 net capital loss available, the actual deduction is limited to the current year's net taxable capital gains of $12,400. The remaining net capital loss carry forward is $43,600 ($56,000 - $12,400).

Exam Exercise Solution Twelve - 5 (Stop Loss Rules)

As Markham has not held the shares for 365 days, this transaction would be subject to the stop loss rules. The deductible loss would be calculated as follows:

Proceeds Of Disposition [($22.11)(1,000)]	$22,110
Adjusted Cost Base [($27.60)(1,000)]	(27,600)
Total Loss	($ 5,490)
Disallowed Portion [($1.97)(1,000)]	1,970
Capital Loss	($ 3,520)
Inclusion Rate	1/2
Allowable Capital Loss	($ 1,760)

Exam Exercise Solution Twelve - 6 (Stop Loss Rules)

As Invest has not held the Glee shares for 365 days, this transaction would be subject to the stop loss rules. Given this, the deductible loss would be calculated as follows:

Proceeds Of Disposition [(5,000)($16.75)]	$83,750
Adjusted Cost Base [(5,000)($18.95)]	(94,750)
Total Loss	($11,000)
Disallowed Portion [(5,000)($1.50)]	7,500
Capital Loss	($ 3,500)
Inclusion Rate	1/2
Allowable Capital Loss	($ 1,750)

Exam Exercise Solution Twelve - 7 (Non-Capital Loss Carry Forward)

The non-capital loss balance at the end of the year would be calculated as follows:

Amount E		
Net Business Loss		$427,500
ABIL		10,450
Dividends Received And Deducted		87,000
Net Capital Loss Carry Forward Deducted*		16,500
Total For Amount E		$541,450
Amount F - ITA 3(c) Income		
Dividends	($87,000)	
Interest	(53,100)	
Net Taxable Capital Gains		
[(1/2)($204,000 - $171,000)]	(16,500)	(156,600)
Non-Capital Loss At End Of Year		$384,850

*While there is a net capital loss carry forward of $37,400 available, the deduction is limited to the net taxable capital gains of $16,500 [($204,000 - $171,000)(1/2)]. This leaves a net capital loss carry forward of $20,900 ($37,400 - $16,500).

Exam Exercise Solution Twelve - 8 (Non-Capital Loss Carry Forward)

The non-capital loss balance at the end of the year would be calculated as follows:

Amount E		
Net Business Loss		$286,000
ABIL		23,000
Dividends Received And Deducted		34,000
Net Capital Loss Carry Forward Deducted*		18,000
Total For Amount E		$361,000
Amount F - ITA 3(c) Income:		
Dividends	($34,000)	
Interest	(42,000)	
Net Taxable Capital Gains	(18,000)	(94,000)
Non-Capital Loss At End Of Year		$267,000

*While there is a net capital loss of $24,000 available, the deduction is limited to the net taxable capital gains of $18,000. This leaves a net capital loss carry forward of $6,000 ($24,000 - $18,000).

Exam Exercise Solution Twelve - 9
(Net Capital And Non-Capital Loss Carry Forwards)

The required calculations for 2015 would be as follows:

Accounting Net Income	$225,000
Adjustments:	
Donations	7,100
Accounting Gain On Sale Of Shares	(33,000)
Taxable Capital Gain [(1/2)($33,000)]	16,500
Net Income For Tax Purposes	**$215,600**
Donations	(7,100)
Dividends Received	(23,000)
Non-Capital Loss Carry Forward (All)	(12,000)
Net Capital Loss Carry Forward (All)	(10,000)
2015 Taxable Income	**$163,500**

There are no carry forwards of any type at the end of 2015.

The net business loss for 2016 would be calculated as follows:

Accounting Net Loss	($372,000)
Charitable Donations	9,600
Accounting Loss On Sale Of Shares	17,000
Dividends Included In Accounting Income	(37,000)
Net Business Loss	($382,400)

The 2016 Net Income For Tax Purposes and Taxable Income would be nil, calculated as follows:

Net Business Loss	($382,400)
Dividends Received	37,000
2016 Net Income For Tax Purposes And Taxable Income	Nil

The non-capital loss for the year is calculated as follows:

Amount E		
Net Business Loss	$382,400	
Dividends Deducted	37,000	$419,400
Amount F (Income Under ITA 3(c) - Dividends)		(37,000)
2016 Non-Capital Loss		$382,400

Of the $382,400 loss, $163,500 can be carried back to 2015, leaving a non-capital loss carry forward of $218,900 ($382,400 - $163,500).

As the policy of the Company is to minimize non-capital losses, none of the 2016 capital loss can be carried back. This will leave a net capital loss carry forward of $8,500 [(1/2)($17,000)].

There is also a carry forward of charitable donations of $9,600.

Exam Exercise Solution Twelve - 10
(Net Capital And Non-Capital Carry Forwards)

The 2015 Net Income For Tax Purposes and Taxable Income would be calculated as follows:

Accounting Income	$427,000
Adjustments:	
Donations	12,100
Accounting Gains	(65,000)
Taxable Capital Gains [(1/2)($65,000)]	32,500
Net Income For Tax Purposes	**$406,600**
Donations	(12,100)
Dividends Received	(41,000)
Non-Capital Loss Carry Forward (All)	(26,000)
Net Capital Loss Carry Forward (All)	(19,000)
2015 Taxable Income	**$308,500**

There are no loss carry forwards at the end of 2015.

The 2016 net business loss would be calculated as follows:

Accounting Loss	($625,000)
Donations	17,600
Accounting Loss On Sale Of Shares	31,000
Dividends Included In Accounting Income	(58,000)
Net Business Loss	($634,400)

The 2016 Net Income For Tax Purposes and Taxable Income would be nil, calculated as follows:

Net Business Loss	($634,400)
Dividends Received	58,000
2016 Net Income For Tax Purposes And Taxable Income	Nil

The 2016 non-capital loss can be calculated as follows:

Amount E		
Net Business Loss	$634,400	
Dividends Deducted	58,000	$692,400
Amount F - (Income Under ITA 3(c) - Dividends)		(58,000)
Non-Capital Loss For 2016		$634,400

The $634,400 non-capital loss can be carried back to 2015 to the extent of that year's Taxable Income of $308,500. This will leave a non-capital loss carry forward of $325,900 ($634,400 - $308,500).

As the Company's policy is to minimize non-capital loss carry overs, none of the share loss can be deducted. This leaves a net capital loss carry over of $15,500 [(1/2)($31,000)]. There is also a $17,600 carry forward of charitable donations.

Exam Exercise Solution Twelve - 11 (Geographical Allocation)

The percentage of Taxable Income earned in each province would be calculated as follows:

	Gross Revenues		Wages And Salaries	
	Amount	**Percent**	**Amount**	**Percent**
Saskatchewan	$1,520,000	50.4%	$ 63,000	32.8%
Alberta	912,000	30.3%	85,000	44.3%
Not Related To A Province	581,000	19.3%	44,000	22.9%
Total	$3,013,000	100.0%	$192,000	100.0%

The average of the two percentages applicable for income not related to a province is 21.1%, leaving an average for income related to a province of 78.9%. Given this, federal Tax Payable can be calculated as follows:

Base Amount Of Part I Tax [(38%)($242,000)]	$91,960
Federal Tax Abatement [(10%)(78.9%)($242,000)]	(19,094)
General Rate Reduction [(13%)($242,000)]	(31,460)
Federal Tax Payable	$41,406

Exam Exercise Solution Twelve - 12 (Geographical Allocation)

The percentage of Taxable Income earned in each province would be calculated as follows:

	Gross Revenues		Wages And Salaries	
	Amount	**Percent**	**Amount**	**Percent**
Ontario	$ 840,000	35%	$ 300,000	25%
Manitoba	1,080,000	45%	540,000	45%
U.S.	480,000	20%	360,000	30%
Total	$2,400,000	100.0%	$1,200,000	100.0%

The average of the two percentages applicable to the U.S. is 25%, leaving an average for income related to a province of 75%. Given this, federal Tax Payable can be calculated as follows:

Base Amount Of Part I Tax [(38%)($362,000)]	$137,560
Federal Tax Abatement [(10%)(75%)($362,000)]	(27,150)
General Rate Reduction [(13%)($362,000)]	(47,060)
Federal Tax Payable	$ 63,350

Exam Exercise Solution Twelve - 13 (Small Business Deduction)

As a CCPC throughout the year and with no associated companies, Meridian is eligible for the full amount of the $500,000 annual business limit. The amount eligible for the small business deduction is the least of:

Active Business Income	**$400,000**
Adjusted Taxable Income (See following calculation)	**$281,786**
Annual Business Limit	**$500,000**

Net Income For Tax Purposes	$522,000
Dividends Received	(72,000)
Non-Capital Loss Carry Forward	(145,000)
Taxable Income	$305,000
100/28 Times Foreign Non-Business Tax Credit [(100/28)(13%)($50,000)]	(23,214)
Adjusted Taxable Income	$281,786

The small business deduction is equal to $49,313 [(17.5%)($281,786)].

Exam Exercise Solution Twelve - 14 (Small Business Deduction)

As a CCPC throughout the year and with no associated companies, Sardo is eligible for the full amount of the $500,000 annual business limit. The amount eligible for the small business deduction is the least of:

Active Business Income	**$375,000**
Adjusted Taxable Income (See following calculation)	**$299,571**
Annual Business Limit	**$500,000**

Net Income For Tax Purposes	$472,000
Dividends Received	(65,000)
Non-Capital Loss Carry Forward	(96,000)
Taxable Income	$311,000
100/28 Times Foreign Non-Business Tax Credit [(100/28)($3,200)]	(11,429)
Adjusted Taxable Income	$299,571

The small business deduction is equal to $52,425 [(17.5%)($299,571)].

Exam Exercise Solution Twelve - 15 (Small Business Deduction Reduction)

The B component of the ITA 125(5.1) reduction formula is $6,638 [(.00225)($12,950,000 - $10,000,000)]. Given this, the required reduction would be calculated as follows:

[($500,000)($6,638 ÷ $11,250)] = $295,022 Reduction

This reduction leaves the annual business limit at $204,978 ($500,000 - $295,022).

The small business deduction for Teeny Ltd. is equal to 17.5 percent of the least of:

• Active Business Income ($652,000 - $21,000)		$631,000
• Taxable Income ($652,000 - $415,000)	$237,000	
[(100/28)(10%)($21,000)]	(7,500)	$229,500
• Reduced Annual Business Limit		$204,978

The small business deduction is equal to $35,871 [(17.5%)($204,978)].

Exam Exercise Solution Twelve - 16 (M&P And SBD)

The small business deduction for Bartlett Operations Inc. would be equal to 17.5 percent of the least of:

• Canadian Active Business Income		$424,000
• Taxable Income ($476,000 - $201,000)	$275,000	
Less 4 Times Business Income FTC Of $3,700	(14,800)	$260,200
• Annual Business Limit		$500,000

Based on this, the small business deduction would be $45,535 [(17.5%)($260,200)].

The M&P deduction would be equal to 13 percent of the lesser of:

• M&P Profits	$424,000	
Less Amount Eligible For Small Business Deduction	(260,200)	$163,800
• Taxable Income	$275,000	
Less:		
Amount Eligible For Small Business Deduction	(260,200)	
4 Times Business Income FTC Of $3,700	(14,800)	
Aggregate Investment Income (Taxable Capital Gain)	(27,000)	Nil

The M&P profits deduction would be equal to nil.

It would have been possible to increase the amount eligible for the small business deduction to the $424,000 of active business income by increasing Taxable Income to $438,800 ($424,000 + $14,800). This could be accomplished by deducting only $37,200 ($476,000 - $438,800) of the charitable donations. The remaining unclaimed donations of $163,800 ($201,000 - $37,200) could be carried forward for up to five years.

Although this increases Taxable Income and the total Tax Payable for the year, there could still be an ultimate tax savings with this approach, as the small business deduction cannot be carried forward, while charitable donations can be. As the Exercise states that Bartlett expects large increases in income in the future, this approach would be advantageous if Bartlett's expectations turn out to be correct.

Exam Exercise Solution Twelve - 17 (M&P And SBD)

The small business deduction for Lardon Inc. would be equal to 17.5 percent of the least of:

• Canadian Active Business Income		$553,000
• Taxable Income ($652,000 - $187,000)	$465,000	
Less 4 Times Business Income FTC Of $6,000	(24,000)	$441,000
• Annual Business Limit		$500,000

Based on this, the small business deduction would be $77,175 [(17.5%)($441,000)].

The M&P deduction would be equal to 13 percent of the lesser of:

• M&P Profits	$553,000	
Less Amount Eligible For Small Business Deduction	(441,000)	$112,000
• Taxable Income ($652,000 - $187,000)	$465,000	
Less:		
Amount Eligible For Small Business Deduction	(441,000)	
4 Times Business Income FTC Of $6,000	(24,000)	
Aggregate Investment Income (Taxable Capital Gain)	(59,000)	Nil

The M&P profits deduction would be equal to nil.

It would have been possible to increase the amount eligible for the small business deduction to the $500,000 annual business limit by increasing Taxable Income to $524,000 ($500,000 + $24,000). This could be accomplished by deducting only $128,000 ($652,000 - $524,000) of the charitable donations. The remaining unclaimed donations of $59,000 ($187,000 - $128,000) could be carried forward for up to five years.

Although this increases Taxable Income and the total Tax Payable for the year, there could still be an ultimate tax savings with this approach, as the small business deduction cannot be carried forward, while charitable donations can be. On the other hand, Lardon's loss of customers and staff may result in substantially lower income in the future. If all income in the foreseeable future will benefit from the small business deduction, it would be advantageous to minimize Taxable Income by deducting all of the charitable donations in the current year.

Exam Exercise Solution Twelve - 18 (Simple Federal Tax Payable - Public Company)

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

Base Amount Of Part I Tax [(38%)($296,000)]	$112,480
Federal Tax Abatement [(10%)($296,000)]	(29,600)
M&P Deduction [(13%)($165,000)]	(21,450)
General Rate Reduction [(13%)($296,000 - $165,000)]	(17,030)
Federal Tax Payable	$ 44,400

Exam Exercise Solution Twelve - 19 (Simple Federal Tax Payable - Public Company)

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

Base Amount Of Part I Tax [(38%)($625,000)]	$237,500
Federal Tax Abatement [(10%)($625,000)]	(62,500)
M&P Deduction [(13%)($362,000)]	(47,060)
General Rate Reduction [(13%)($625,000 - $362,000)]	(34,190)
Federal Tax Payable	$ 93,750

Exam Exercise Solution Twelve - 20 (Simple Federal Tax Payable - CCPC)

The federal Tax Payable for Danforth Inc. would be calculated as follows:

Base Amount Of Part I Tax [(38%)($262,000)]	$99,560
Federal Tax Abatement [(10%)($262,000)]	(26,200)
Small Business Deduction (Note One)	(20,475)
M&P Deduction (Note Two)	(10,920)
General Rate Reduction (Note Three)	(7,930)
Federal Tax Payable	$34,035

Note One The small business deduction would be equal to 17.5 percent of the least of active business income ($262,000), Taxable Income ($262,000), and the Company's business limit ($117,000). The deduction is $20,475 [(17.5%)($117,000)].

Note Two The M&P deduction would be equal to 13 percent of the lesser of $84,000 (M&P profits of $201,000, reduced by the $117,000 that is eligible for the small business deduction), and $145,000 (Taxable Income, reduced by the $117,000 that is eligible for the small business deduction). The M&P deduction would be $10,920 [(13%)($84,000)].

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

Taxable Income	$262,000
Amount Eligible For The SBD	(117,000)
Amount Eligible For The M&P Deduction	(84,000)
Full Rate Taxable Income	$ 61,000
Rate	13%
General Rate Reduction	$ 7,930

Exam Exercise Solution Twelve - 21 (Simple Federal Tax Payable - CCPC)

The federal Tax Payable for Brokton Inc. would be calculated as follows:

Base Amount Of Part I Tax [(38%)($472,000)]	$179,360
Federal Tax Abatement [(10%)($472,000)]	(47,200)
Small Business Deduction (Note 1)	(24,500)
M&P Deduction (Note 2)	(21,450)
General Rate Reduction (Note 3)	(21,710)
Federal Tax Payable	$ 64,500

Note 1 The small business deduction would be equal to 17.5 percent of the least of:

- Active Business Income $472,000
- Taxable Income $472,000
- Company's Business Limit $140,000

The amount would be $24,500 [(17.5%)($140,000)].

Note 2 The M&P deduction would be 13% of the lesser of:

- $165,000 - M&P profits, less the amount eligible for the small business deduction ($305,000 - $140,000).
- $332,000 - Taxable income, less the amount eligible for the small business deduction ($472,000 - $140,000).

The amount would be $21,450 [(13%)($165,000)].

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

Taxable Income	$472,000
Amount Eligible For The SBD	(140,000)
Amount Eligible For The M&P Deduction	(165,000)
Full Rate Taxable Income	$167,000
Rate	13%
General Rate Reduction	$ 21,710

Exam Exercise Solution Twelve - 22 (Foreign Tax Credits)

The Taxable Income figure would be $42,000 ($135,000 - $23,000 - $51,000 - $19,000). Based on this figure, the required calculation of Part I Tax Payable would be as follows:

Base Amount Of Part I Tax [(38%)($42,000)]	$15,960
Federal Tax Abatement [(91%)(10%)($42,000)]	(3,822)
General Rate Reduction [(13%)($42,000)]	(5,460)
Foreign Business Income Tax Credit (See Note)	(3,048)
Part I Tax Payable	$ 3,630

Note The foreign business income tax credit would be the least of:

• The amount withheld	$ 4,050
• [$27,000 ÷ ($135,000 - $23,000 - $19,000)][$15,960 - $5,460]	$ 3,048
• $15,960 - $5,460	$10,500

The unused foreign business tax amount of $1,002 ($4,050 - $3,048) can be carried back 3 years and forward for 10 years. In calculating the allowable tax credit for such carry overs, these unused amounts will be added to the foreign tax paid factor in the calculation of the foreign business income tax credit.

Exam Exercise Solution Twelve - 23 (Foreign Tax Credits)

Sundal's Part I Tax Payable is calculated as follows:

Base Amount Of Part I Tax [(38%)($83,000)]	$31,540
Federal Tax Abatement [(89%)(10%)($83,000)]	(7,387)
General Rate Reduction [(13%)($83,000)]	(10,790)
Foreign Business Income Tax Credit (See Note)	(5,298)
Part I Tax Payable	$ 8,065

Note The foreign business income tax credit would be the least of:

• The amount withheld	$ 7,200
• [$48,000 ÷ ($265,000 - $41,000 - $36,000)][$31,540 - $10,790]	$ 5,298
• $31,540 - $10,790	$20,750

The unused foreign business tax amount of $1,902 ($7,200 - $5,298) can be carried back 3 years and forward for 10 years. In calculating the allowable tax credit for such carry overs, these unused amounts will be added to the foreign tax paid factor in the calculation of the foreign business income tax credit.

TIF Solution Twelve - 5A

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

A. 8

B. 1

C. 5

D. 11

E. 6

F. 9

G. 4

H. 7

The three unused definitions are as follows:

Associated Corporations = 10

Personal Services Business = 2

Specified Investment Business = 3

TIF Solution Twelve - 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. 10 (not 3)

B. 1 (not 8)

C. 6

D. 15

E. 7 (not 14)

F. 12

G. 5

H. 9

The three unused definitions are as follows:

Associated Corporations = 13

Personal Services Business = 2

Specified Investment Business = 4

Specified Investment Business (close answer) = 11

TIF Solution Twelve - 6

Part 1 The adjustment for this Part is an addition of the $15,000 in charitable donations.

Part 2 Two adjustments are required for this Part.

- The addition of the accounting loss on the sale of $42,000 ($120,000 - $162,000).
- The deduction of the terminal loss of $11,500 ($131,500 - $120,000).

Part 3 Two adjustments are required for this Part.

- The addition of the accounting write-down (goodwill impairment loss) of $19,400.
- The deduction of $5,093 for the write-off of cumulative eligible capital [($97,000)(3/4)(7%)].

Part 4 Two adjustments are required for this Part.

- The addition of $176,000 for accounting amortization.
- The deduction of $220,000 for maximum CCA.

Part 5 Two adjustments are required for this Part.

- The deduction of the accounting gain of $75,000 ($250,000 - $175,000).
- The addition of the taxable capital gain, net of the maximum capital gains reserve. As the $62,500 [(25%)($250,000)] in proceeds received is greater than 20 percent of the total proceeds, the maximum capital gains reserve is equal to $56,250 {[$250,000 - $175,000][($250,000 - $62,500) ÷ $250,000]}. The net addition is equal to $9,375 [(1/2)($250,000 - $175,000 - $56,250 reserve].

Part 6 There would a deduction of $3,000 for premium amortization and an addition of $4,200 for discount amortization, a net addition of $1,200.

Part 7 The adjustment for this Part is an addition of $25,000 for the five non-deductible memberships. There is no adjustment related to the entertainment costs as they were not paid by the Company.

Summary Of Adjustments (Not Required)

Part 1		$15,000
Part 2	$ 42,000	
	(11,500)	30,500
Part 3	$ 19,400	
	(5,093)	14,307
Part 4	$176,000	
	(220,000)	(44,000)
Part 5	($ 75,000)	
	9,375	(65,625)
Part 6	($ 3,000)	
	4,200	1,200
Part 7		25,000
Total Of Adjustments		($23,618)

TIF Solution Twelve - 7

The Taxable Income of Dunway Ltd. would be calculated as follows:

Operating Income ($725,000 - $533,000)		$192,000
Dividends Received ($37,500 + $15,000)		52,500
Taxable Capital Gain [(1/2)($222,000)]		111,000
Net Income For Tax Purposes		**$355,500**
Deductions:		
Dividends Received	($ 52,500)	
Donation To Government (Note 1)	(26,000)	
Donations To Registered Charities (Note 1)	(141,000)	
Net Capital Loss Carry Forward (Note 2)	(111,000)	(330,500)
Taxable Income Before Non-Capital Loss Carry Forward		$ 25,000
Non-Capital Loss Carry Forward (Note 3)		(25,000)
Taxable Income		**Nil**

Note 1 There is no addition to Net Income For Tax Purposes with respect to the donations as this calculation does not start with accounting Net Income. The donations to registered Canadian charities total less than 75 percent of Net Income For Tax Purposes and are therefore fully deductible in the calculation of Taxable Income.

Note 2 The net capital loss carry forward can only be deducted to the extent of the $111,000 taxable capital gain.

Note 3 The non-capital loss carry forward has only been deducted to the extent of the amount required to reduce Taxable Income to nil. It would have been possible to carry forward the donations instead, but the non-capital loss carry forward period is greater than the five year donation carry forward.

Loss Carry Forwards

At the end of the current year, Dunway will have:

- a net capital loss balance of $69,000 ($180,000 - $111,000). Since the problem states that no future capital gains are anticipated, the maximum amount of the net capital loss carry forward was claimed first.
- a non-capital loss carry forward of $112,000 ($137,000 - $25,000).

TIF Solution Twelve - 8

The Net Income For Tax Purposes and Taxable Income of Sedux Inc. for the 9 month period ending September 30, 2016 is as follows:

Accounting Income Before Taxes		$ 55,000
Add:		
Reserve For Inventory Obsolescence (Included In Cost Of Sales)	$15,000	
Bonus (Note 1)	10,000	
Amortization	46,000	
Non-Deductible Meals And Entertainment [(1/2)($10,000)]	5,000	
Golf Club Memberships	4,000	
Warranty Reserve	4,700	
Charitable Donations	2,400	
Taxable Capital Gain On Investments [(1/2)($3,000)]	1,500	88,600
Deduct:		
Accounting Gain On Sale Of Investments	($ 3,000)	
CCA (Note 2)	(29,993)	(32,993)
Net Income For Tax Purposes		**$110,607**
Deduct:		
Charitable Donations	($ 2,400)	
Net Capital Loss Carry Forward Limited To Taxable Capital Gains	(1,500)	
Non-Capital Loss Carry Forward (All)	(16,000)	(19,900)
Taxable Income		**$ 90,707**

Note 1 As the bonus is not paid until more than 180 days, but less than 3 years after the Company's fiscal year end, it cannot be deducted until it is paid.

Note 2 The CCA for the 9 month period ending September 30, 2016 (273 days), can be calculated as follows:

Class 8 Opening UCC		$68,000
Additions	$18,000	
Disposals - Lesser Of:		
• Capital Cost = $12,000		
• Proceeds Of Disposition = $8,000	(8,000)	10,000
One-Half Net Additions [(1/2)($10,000)]		(5,000)
CCA Base		$73,000
Rate (Class 8)		20%
Full Year Amount		$14,600
Proration For Short Fiscal Year		273/365
Class 8 CCA		$10,920

The total CCA for the 9 month period ending September 30, 2016 would be as follows:

Class 8 CCA (Preceding Calculation)	$10,920
Class 10 CCA [(30%)($85,000)(273/365)]	19,073
Total CCA	$29,993

The following additional points are relevant to the solution:

- Dividends declared are not deducted in the calculation of either accounting Net Income or Taxable Income.
- The interest expense is fully deductible.
- Where a foreign exchange loss arises in the normal course of business operations, it is fully deductible.

Loss Carry Forward

As noted, the net capital loss carry forward deducted is limited to the taxable capital gain of $1,500. At the end of the current year, Sedux Inc. will have a net capital loss balance of $3,500 ($5,000 - $1,500). There is no remaining non-capital loss carry forward.

TIF Solution Twelve - 9

The required calculation of Net Income For Tax Purposes and Taxable Income is as follows:

ITA 3(a) Dividends		$ 36,450
ITA 3(b) Taxable Capital Gains	$27,360	
Allowable Capital Losses	(4,990)	22,370
ITA 3(c)		$ 58,820
ITA 3(d) Business Loss		(152,480)
Net Income For Tax Purposes		Nil
Dividends Received		($ 36,450)
Net Capital Loss Carry Forward (Limited To Net Taxable Capital Gains)		(22,370)
Charitable Donations		Nil
Taxable Income		Nil

The carry forward balances available at the end of the year are as follows:

Net Capital Loss Carry Forward

Beginning Balance	$55,725
Used During Year	(22,370)
Net Capital Loss Carry Forward	$33,355

Charitable Donations Carry Forward

Beginning Balance	$4,220
Added During Year	3,940
Used During Year	Nil
Unused Charitable Donations	$8,160

Non-Capital Loss

Balance Under E	
Dividends	$ 36,450
Business Loss	152,480
Net Capital Loss Carry Forward Deducted	22,370
Subtotal	$211,300
Balance Under F - Income Under ITA 3(c)	(58,820)
Non-Capital Loss	$152,480

Non-Capital Loss Carry Forward

Balance From Previous Years	$ 44,560
Added During Year	152,480
Used During Year	Nil
Non-Capital Loss Carry Forward	$197,040

As per the policy of the Company, this solution minimizes the net capital loss carry forward. In the absence of this policy, an alternative solution could minimize the non-capital loss balance.

TIF Solution Twelve - 10

The required calculation of Net Income For Tax Purposes and Taxable Income is as follows:

ITA 3(a) Dividends		$ 51,500
ITA 3(b)		
Taxable Capital Gains [(1/2)($41,500)]	$20,750	
Allowable Capital Losses [(1/2)($7,300)]	(3,650)	17,100
ITA 3(c)		$ 68,600
ITA 3(d) Business Loss		(225,000)
Net Income For Tax Purposes		**Nil**
Dividends Received		($ 51,500)
Net Capital Loss Carry Forward		
(Limited To Net Taxable Capital Gains)		(17,100)
Charitable Donations		Nil
Taxable Income		**Nil**

The carry forward balances available at the end of the year are as follows:

Net Capital Loss Carry Forward

Beginning Balance	$78,250
Used During Year	(17,100)
Net Capital Loss Carry Forward	$61,150

Charitable Donations Carry Forward

Beginning Balance	$ 6,400
Added During Year	6,300
Used During Year	Nil
Unused Charitable Donations	$12,700

2016 Non-Capital Loss

Balance Under E	
Dividends Received And Deducted	$ 51,500
Business Loss	225,000
Net Capital Loss Carry Forward Deducted	17,100
Subtotal	$293,600
Balance Under F - Income Under ITA 3(c)	(68,600)
2016 Non-Capital Loss	$225,000

Non-Capital Loss Carry Forward

Balance From Previous Years	$ 61,400
Added During Year	225,000
Used During Year	Nil
Non-Capital Loss Carry Forward	$286,400

As per the policy of the Company, this solution minimizes the net capital loss carry forward. In the absence of this policy, an alternative solution could minimize the non-capital loss balance.

TIF Solution Twelve - 11

2013 Analysis

Net And Taxable Income

The required calculations for Net Income For Tax Purposes and Taxable Income are as follows:

Net Business Income	$123,000
Dividends	6,000
Net Income For Tax Purposes	**$129,000**
Dividends	(6,000)
Charitable Donations	(1,500)
Taxable Income	**$121,500**

There is an allowable capital loss of $6,000 [(1/2)($12,000)] that can only be deducted against taxable capital gains.

2013 Carry Forwards

The following carry forward amount is available at the end of 2013:

- Net Capital Loss $6,000

2014 Analysis

Net And Taxable Income

The required calculations for Net Income For Tax Purposes and Taxable Income are as follows:

Net Business Income	$18,000
Taxable Capital Gain [(1/2)($32,000)]	16,000
Dividends	7,000
Net Income For Tax Purposes	**$41,000**
Dividends	(7,000)
Charitable Donations	(8,500)
Net Capital Loss Carry Forward (All)	(6,000)
Taxable Income	**$19,500**

2014 Carry Forwards

As the Company was able to deduct all of the net capital loss from 2013, no carry forward amounts remain.

2015 Analysis

Net And Taxable Income

The required calculations for Net Income For Tax Purposes and Taxable Income are as follows:

Dividends = Income Under ITA 3(c)	$ 6,000
Business Loss [ITA 3(d)]	(85,000)
Net Income For Tax Purposes And Taxable Income	Nil

Net Capital Loss Carry Back And Amended 2014 Return

In 2015, there is a net capital loss of $12,500 [(1/2)($25,000)]. While there was a $16,000 taxable capital gain in 2014, $6,000 of this amount was used by the net capital loss carry forward from 2013. This means that only $10,000 of the $12,500 can be carried back to 2014. Given this, the 2014 amended return would be as follows:

Taxable Income As Reported	$19,500
Net Capital Loss Carry Back From 2015	(10,000)
Amended 2014 Taxable Income	$ 9,500

Non-Capital Loss Carry Back And Amended 2013 Return

The 2015 non-capital loss would be calculated as follows:

Business Loss	$85,000
Dividends Received And Deducted	6,000
Amount E	$91,000
Income Under ITA 3(c)	(6,000)
2015 Non-Capital Loss	$85,000

As the 2013 Taxable Income was $121,500, all of this loss can be carried back to that year. Given this, the amended return for 2013 would be as follows:

Taxable Income As Reported In 2013	$121,500
Non-Capital Loss Carry Back from 2015	(85,000)
Amended 2013 Taxable Income	$ 36,500

2015 Carry Forwards

The following carry forward amounts are available at the end of 2015:

• Net Capital Loss ($12,500 - $10,000)	$2,500
• Charitable Donations	4,200
• Non-Capital Loss	Nil

2016 Analysis

Net And Taxable Income

The required calculations for Net Income For Tax Purposes and Taxable Income are as follows:

Net Business Income	$32,000
Taxable Capital Gains	8,000
Dividends	9,000
Net Income For Tax Purposes	**$49,000**
Dividends	(9,000)
Current Charitable Donations	(1,800)
Charitable Donations Carry Forward	(4,200)
Net Capital Loss Carry Forward (All)	(2,500)
Taxable Income	**$31,500**

2016 Carry Forwards

At the end of 2016, there are no carry forward balances.

TIF Solution Twelve - 12

The allocation to each of these provinces and the United States would be based on the following calculations:

Province	Salaries And Wages Amount	Salaries And Wages Percent	Gross Revenues Amount	Gross Revenues Percent
Manitoba	$ 369,750	15%	$1,252,000	20%
Ontario	616,250	25%	1,565,000	25%
Quebec	986,000	40%	2,191,000	35%
United States	493,000	20%	1,252,000	20%
Total	$2,465,000	100%	$6,260,000	100%

The province by province average of the two percentages, calculated above, would be used to allocate the total Taxable Income of $1,467,000 as follows:

Province	Wages	Revenues	Average	Taxable Income
Manitoba	15%	20%	17.5%	$ 256,725
Ontario	25%	25%	25.0%	366,750
Quebec	40%	35%	37.5%	550,125
United States	20%	20%	20.0%	293,400
Total	100%	100%	100.0%	$1,467,000

TIF Solution Twelve - 13

Kalec's Part I tax payable for the year would be calculated as follows:

Base Amount Of Part I Tax [(38%)($879,000)]	$334,020
Federal Tax Abatement [(10%)(80.5%)($879,000)] (Note One)	(70,760)
Foreign Business Tax Credit (Assumed To Be Equal To Taxes Withheld)	(17,550)
Small Business Deduction (Note Two)	(19,354)
General Rate Reduction (Note Three)	(99,893)
Part I Tax Payable	$126,463

Note One The federal tax abatement must be reduced because of the foreign business income. The percentage would be calculated as follows:

Canadian Gross Revenues As A Percentage Of Total	78%
Canadian Wages And Salaries As Percentage Of Total	83%

Using these figures, the average percent would be 80.5 percent [(78% + 83%) ÷ 2].

Note Two Since Kalec's Taxable Capital Employed In Canada during 2015 was greater than $10 million, its small business deduction is reduced. The B component of the ITA 125(5.1) reduction formula is $5,029 [(.00225)($12,235,000 - $10,000,000)]. In addition, because of Kalec's association with other companies, the A component of the formula would be reduced to $200,000 [($500,000)(40%)]. Given these considerations, the reduction would be calculated as follows:

[($200,000)($5,029 ÷ $11,250)] = $89,404 Reduction

Using this information, Kalec's small business deduction is equal to 17.5 percent of the least of:

Canadian Active Business Income		$762,000
Taxable Income	$879,000	
Foreign Business Tax Credit Adjusted [(4)($17,550)]	(70,200)	$808,800
Reduced Annual Business Limit ($200,000 - $89,404)		$110,596

The small business deduction would be $19,354 [(17.5%)($110,596)].

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

Taxable Income	$879,000
Amount Eligible For Small Business Deduction	(110,596)
Full Rate Taxable Income	$768,404
Rate	13%
General Rate Reduction	$ 99,893

TIF Solution Twelve - 14

The minimum Taxable Income for Blackman Inc. would be calculated as follows:

Net Income For Tax Purposes		$624,300
Deductions:		
Dividends	($198,000)	
Charitable Donations	(64,700)	
Non-Capital Loss Carry Forward	(72,400)	(335,100)
Taxable Income		$289,200

Based on this, the Company's Tax Payable would be calculated as follows:

Base Amount Of Part I Tax [(38%)($289,200)]	$109,896
Federal Tax Abatement [(10%)($289,200)]	(28,920)
Small Business Deduction (Note 1)	(17,500)
M&P Deduction (Note 2)	(24,596)
General Rate Reduction (Note 3)	Nil
Part I Federal Tax Payable	$ 38,880

Note 1 The small business deduction is based on the least of the following:

Canadian Active Business Income	$426,300
Taxable Income (no foreign tax credit adjustment needed)	289,200
Annual Business Limit [(20%)($500,000)]	100,000

The small business deduction is equal to $17,500 [(17.5%)($100,000)].

Note 2 The base for the Manufacturing And Processing Deduction would be the lesser of:

M&P Profits (Given)	$334,000	
Amount Eligible For The SBD	(100,000)	$234,000
Taxable Income	$289,200	
Amount Eligible For The SBD	(100,000)	
Aggregate Investment Income	Nil	$189,200

Based on these figures, the deduction would be equal to $24,596 [(13%)($189,200)].

Note 3 The General Rate Reduction would be calculated as follows:

Taxable Income	$289,200
Amount Eligible For The SBD	(100,000)
Amount Eligible For The M&P Deduction	(189,200)
Base	$ Nil

TIF Solution Twelve - 15

Part A - Tax Payable

The calculation of federal Part I Tax Payable would be as follows:

Canadian Active Business Income	$187,000
Foreign Income (U.S. Branches)	32,000
Net Income For Tax Purposes And Taxable Income	$219,000
Base Amount of Part I Tax [(38%)($219,000)]	$ 83,220
Federal Tax Abatement [(10%)(90%)($219,000)] - Note One	(19,710)
Small Business Deduction - Note Two	(31,605)
General Rate Reduction - Note Three	(4,992)
Foreign Business Income Tax Credit - Given	(9,600)
Part I Tax Payable	$ 17,313

Note One Since only 90 percent of the Company's Taxable Income is allocated to Canadian provinces, the abatement must be multiplied by 90 percent.

Note Two The small business deduction would be equal to 17.5 percent of the least of:

1.	Canadian Active Business Income		$187,000
2.	Taxable Income	$219,000	
	Less [(4)($9,600)]	(38,400)	$180,600
3.	Annual Business Limit		$500,000

The least of the three figures is $180,600, and 17.5 percent of this amount is $31,605.

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

Taxable Income	$219,000
Amount Eligible For Small Business Deduction	(180,600)
Full Rate Taxable Income	$ 38,400
Rate	13%
General Rate Reduction	$ 4,992

Part B - Foreign Tax Credit

The foreign business income tax credit is $9,600, the least of the following three amounts:

- Actual Foreign Taxes Withheld ($6,200 + $3,400) $9,600
- An amount calculated as follows:

  [Foreign Business Income ÷ Adjusted Net Income][Tax Otherwise Payable]
  = [($32,000 ÷ $219,000)($83,220 - $4,992)] $11,431
- Tax Otherwise Payable,
  Less Non-Business Foreign Tax Credit Deducted [($83,220 - $4,992) - Nil] $78,228

Note that the tests of the foreign tax credit amounts include the effect of the general rate reduction.

TIF Solution Twelve - 16

The minimum Taxable Income for Zenox Ltd. would be calculated as follows:

Net Income For Tax Purposes		$625,000
Deductions:		
Dividends	($102,000)	
Charitable Donations	(46,000)	
Non-Capital Loss Carry Forward	(54,000)	(202,000)
Taxable Income		$423,000

Based on this, the Company's Tax Payable would be calculated as follows:

Base Amount Of Part I Tax [(38%)($423,000)]	$160,740
Federal Tax Abatement [(10%)($423,000)]	(42,300)
Small Business Deduction (Note 1)	(43,750)
M&P Deduction (Note 2)	(21,580)
General Rate Reduction (Note 3)	(910)
Part I Federal Tax Payable	$ 52,200

Note 1 The small business deduction is based on the least of the following:

Active Business Income	$523,000
Taxable Income (no foreign tax credit adjustment needed)	423,000
Annual Business Limit [(1/2)($500,000)]	250,000

The small business deduction is equal to $43,750 [(17.5%)($250,000)].

Note 2 The base for the Manufacturing And Processing Deduction would be the lesser of:

M&P Profits (Given)	$416,000	
Amount Eligible For The SBD	(250,000)	$166,000
Taxable Income	$423,000	
Amount Eligible For The SBD	(250,000)	$173,000

Based on these figures, the deduction would be equal to $21,580 [(13%)($166,000)].

Note 3 The General Rate Reduction would be calculated as follows:

Taxable Income	$423,000
Amount Eligible For The SBD	(250,000)
Amount Eligible For The M&P Deduction	(166,000)
Full Rate Taxable Income	$ 7,000
Rate	13%
General Rate Reduction	$ 910

TIF Solution Twelve - 17

Note to Instructor As the ART is not covered until Chapter 13, this problem does not require the calculation of the ART which would be nil due to the capital loss carry forward applied.

Part A - Net Income For Tax Purposes

The calculation of MIL's Net Income For Tax Purposes would be as follows:

Accounting Net Income Before Taxes		$ 609,400
Additions:		
Amortization Expense (Income Statement)	$285,000	
Taxable Capital Gain On Building (Note 1)	7,500	
Taxable Capital Gain On Land (Note 1)	12,500	
Taxable Capital Gain On Vacant Land (Note 2)	5,100	
Recapture On Building (Note 3)	125,646	
Accounting Loss On Vehicles (Income Statement)	40,000	
Non-Deductible Meals And Entertainment (50% of $32,000)	16,000	
Golf Club Membership Fees	14,600	
Articles Of Incorporation Amendment Costs	13,500	
Bond Discount Amortization	3,500	
Donations To Registered Charities	3,400	
Interest On Late Income Tax Instalments	900	
Foreign Tax Withheld	2,400	530,046
		$1,139,446
Deductions:		
Accounting Gain On Building (Income Statement)	($ 75,000)	
Accounting Gain On Vacant Land (Income Statement)	(51,000)	
Landscaping	(15,000)	
Capital Cost Allowance (Note 3)	(287,102)	
Terminal Loss (Note 3)	(19,417)	
Write-Off Of CEC (Note 4)	(4,859)	(452,378)
Net Income For Tax Purposes		$ 687,068

Note 1 While the accounting gain on the building is calculated on the combined value of the land and building, separate tax figures are required for each asset. The taxable capital gain on the building is calculated as follows:

Proceeds Of Disposition ($1,185,000 - $225,000)	$960,000
Capital Cost ($1,145,000 - $200,000)	(945,000)
Capital Gain	$15,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 7,500

In addition to the taxable capital gain on the building, there will be a taxable capital gain on the land of $12,500 [(1/2)($225,000 - $200,000)]

Note 2 There is a capital gain on the vacant land of $51,000 ($623,000 - $572,000). However, as not all of the proceeds of disposition were received in 2016, a reserve can be deducted. The reserve will be the lesser of the following two amounts:

- [($51,000)($573,000 ÷ $623,000)] = $46,907
- [($51,000)(20%)(4 - 0] = $40,800

Deducting the lesser amount leaves a capital gain of $10,200 ($51,000 - $40,800), and a taxable capital gain of $5,100 [(1/2)($10,200)].

Note 3 Maximum CCA and other related inclusions and deductions are found in the tables which follow. Note that the new building was added to a separate Class in order to qualify for the enhanced CCA rate of 10 percent. This resulted in recapture on the old building that was disposed of.

Class 1 - Old Building

January 1, 2016 Class 1 Balance	$819,354
Disposition - Lesser Of:	
• Proceeds = $960,000 ($1,185,000 - $225,000)	
• Capital Cost = $945,000 ($1,145,000 - $200,000)	(945,000)
Negative Ending UCC Balance	($125,646)
Recapture	125,646
January 1, 2017 UCC Balance	Nil

Class 1 - New Building

New Class 1 Addition ($1,425,000 - $260,000)	$1,165,000
One-Half Net Additions	(582,500)
Balance	$ 582,500
CCA [(10%)($582,500)]	(58,250)
One-Half Net Additions	582,500
January 1, 2017 UCC Balance	$1,106,750

Class 8

January 1, 2016 Class 8 Balance	$ 985,261
Additions	98,000
One-Half Net Additions	(49,000)
CCA Base	$1,034,261
CCA [(20%)($1,034,261)]	(206,852)
One-Half Net Additions	49,000
January 1, 2017 UCC Balance	$ 876,409

Class 10

January 1, 2016 Class 10 Balance	$96,417
Disposition - Lesser Of:	
• Proceeds = $77,000	
• Capital Cost = $193,000	(77,000)
Positive Ending Balance With No Assets Left In Class	$ 19,417
Terminal Loss	(19,417)
January 1, 2017 UCC Balance	Nil

Class 13

January 1, 2016 Class 13 Balance	$187,000
2016 CCA:	
2014 Expenditures ($180,000 ÷ 10 Years)	(18,000)
2015 Expenditures ($36,000 ÷ 9 Years)	(4,000)
January 1, 2017 UCC Balance	$165,000

Summary Of CCA And UCC Results

Class	Maximum CCA	UCC
Class 1 - Old (Recapture = $125,646)	Nil	Nil
Class 1 - New	$ 58,250	$1,106,750
Class 8	206,852	876,409
Class 10 (Terminal Loss = $19,417)	Nil	Nil
Class 13 ($18,000 + $4,000)	22,000	165,000
Total	$287,102	

Note 4 The 2016 amortization and the January 1, 2017 balance of the cumulative eligible capital account can be calculated as follows:

2015 Addition [(3/4)($85,000)]	$63,750
2015 CEC Amount At 7 Percent	(4,463)
Opening Balance, 2016	$59,287
2016 Addition Of Legal Fees [(3/4)($13,500)]	10,125
2016 Base	$69,412
2016 CEC Amount At 7 Percent	(4,859)
January 1, 2017 CEC Balance	$64,553

Part B - Taxable Income

MIL's Taxable Income would be calculated as follows:

Net Income For Tax Purposes	$687,068
Dividends From Taxable Canadian Corporations	(37,000)
Contributions To Registered Charities	(3,400)
Net Capital Loss Carry Over (Note 5)	(25,100)
Non-Capital Loss Carry Over (All)	(60,300)
Taxable Income	$561,268

Note 5 MIL's Net Income For Tax Purposes contained net taxable capital gains calculated as follows:

Taxable Capital Gain On Building	$ 7,500
Taxable Capital Gain On Building Land	12,500
Taxable Capital Gain On Vacant Land	5,100
Total Taxable Capital Gains	$25,100

While there is a net capital loss of $128,000, the amount to be used is limited to the $25,100 in net taxable capital gains for the year.

Part B - Loss Carry Forwards

At the end of 2016, there would be a net capital loss carry forward of $102,900 ($128,000 - $25,100). There is no remaining non-capital loss carry forward.

Part C - Tax Payable

MIL's Tax Payable would be calculated as follows:

Base Amount Of Part I Tax [(38%)($561,268)]	$213,282
Federal Tax Abatement [(10%)(93%)($561,268)]	(52,198)
Small Business Deduction (Note 6)	(26,250)
General Rate Reduction (Note 7)	(53,465)
Foreign Business Tax Credit (Given)	(2,400)
Part I Tax Payable	$ 78,969

Note 6 The amount eligible for the small business deduction would be the least of the following amounts:

Canadian Source Active Business Income (Given)	**$613,168**
Taxable Income	$561,268
Less: 4 Times The Foreign Business Tax Credit [(4)($2,400)]	(9,600)
Adjusted Taxable Income	**$551,668**
Annual Business Limit (Given)	**$150,000**

The least of these figures is $150,000, resulting in a small business deduction of $26,250 [(17.5%)($150,000)].

Note 7 The general rate reduction would be calculated as follows:

Taxable Income	$561,268
Amount Eligible For The Small Business Deduction	(150,000)
Full Rate Taxable Income	$411,268
Rate	13%
General Rate Reduction	$ 53,465

Chapter Thirteen Test Item File Solutions

TIF Solution Thirteen - 1

1. As presented in the text, the two views can be described as follows:

   Entity View The entity view holds that corporations have a perpetual life of their own, that they are independent of their shareholders, and that they are legal entities. As such, they should pay tax separately on their earnings.

   Integration View Under the integration approach to the taxation of business income, corporations are viewed as simply the legal form through which one or more individuals (shareholders) carry on business. Therefore, business income that flows through a corporation to an individual should not be taxed differently, in total, from business income earned directly by that individual as a proprietor or partner.

2. The basic objective of integration is to neutralize the effect of incorporating a source of income. That is, integration procedures attempt to ensure that, for a given income source, the after tax amount that will be received by an individual will be the same, whether the income is received directly or, alternatively, flowed through a corporation. This would mean that the individual taxes paid on income received directly would be equal to the combined corporate and individual taxes paid on income flowed through a corporation.

   In a somewhat broader sense, full integration would imply that the timing of the tax payments would be the same under the two alternatives. That is, integration should serve to prevent a corporation from being used to defer payment of part of the total tax obligation.

3. The 17 percent gross up of dividends received is based on the assumption of a notional 14.53 percent tax rate being applicable at the corporate level. When this rate is applicable, the 17 percent gross up restores the Taxable Income to the same amount that was initially earned at the corporate level.

   After the shareholder's taxes are calculated, a dividend tax credit is deducted. At the federal level, this credit equals 21/29 of the gross up. In those cases where the provincial tax credit is equal to 8/29 of the gross up, the result is a combined credit that is equal to the gross up. As the 17 percent gross up reflects corporate taxes paid at a 14.53 percent rate, this combined credit will eliminate the effect of corporate taxation, thereby achieving the basic goal of integration, assuring that the same amount of taxes will be paid whether the income is received directly or channeled through a corporation.

4. As defined in ITA 129(4), aggregate investment income is made up of:

   - Net taxable capital gains for the year, reduced by any net capital loss carry overs deducted during the year.
   - Property income other than dividends that are deductible in determining the corporation's Taxable Income.

5. Aggregate investment income includes taxable gains, reduced by any net capital losses deducted during the year. Property income does not include taxable capital gains. These items are covered in subdivision c of the *Income Tax Act*.

   Property income includes dividends from Canadian corporations. Aggregate investment income does not include dividends that are deductible in determining the corporation's Taxable Income.

6. When a corporation's income is distributed to its shareholders, the Part I refund lowers the effective corporate tax rate to about 20 percent. However, until the income is distributed, the rate is between 49-2/3 and 54-2/3 percent, depending on what province the corporation's income is taxed in. As this rate is similar to that which is applicable on the direct receipt of investment income, it makes no economic sense to place investments in a corporation unless there is an intent to distribute most of the resulting income to shareholders. If, alternatively, the corporate tax rate had been lowered to 20 percent, the corporation could be used to shelter investment income. It would appear that the policy goal of using a refundable tax, as opposed to a lower corporate tax rate, is to prevent the corporation from being used to shelter investment income from current taxation.

7. The objective is to discourage the use of a corporation to shelter income from property. This additional tax is assessed on the aggregate investment income of a Canadian controlled private corporation in order to raise the combined federal/provincial tax rate on the investment income of such companies to a level that is as high or higher than the combined federal/provincial rate that would be paid by an individual in the highest tax bracket on direct receipt of the income. When this is accomplished, the individual has no tax incentive to channel this type of income into a CCPC. In the absence of this tax, the corporate tax rate could be lower than the individual tax rate, resulting in a deferral of tax until such time as the income is distributed as dividends.

8. The problem here is that a corporation will receive dividends on a tax free basis. If these are portfolio dividends or dividends on which the payor corporation has received a dividend refund, the result will be a significant amount of deferral, relative to direct receipt of such dividends, through the use of a corporation. Imposing a Part IV refundable tax on portfolio dividends and dividends received from a connected corporation, on which the payor received a refund (dividends paid by a private corporation or a subject corporation out of investment income) corrects this imperfection in the integration system. By making the tax refundable, the goal of having the total corporate and personal taxes approximate the taxes that would be imposed on an individual receiving the income directly is still achieved.

9. A subject corporation is defined in ITA 186(3) as follows:

   Subject Corporation means a corporation (other than a private corporation) resident in Canada and controlled, whether because of a beneficial interest in one or more trusts or otherwise, by or for the benefit of an individual (other than a trust) or a related group of individuals (other than trusts).

   For purposes of Part IV tax, subject corporations are treated as private corporations, despite the fact that some of their shares are publicly traded.

10. A connected corporation is either:

    - a controlled corporation, where control represents ownership of more than 50 percent of the voting shares by any combination of the other corporation and persons with whom it does not deal at arm's length, or
    - a corporation in which the other corporation owns more than 10 percent of the voting shares, and more than 10 percent of the fair market value of all of the issued shares of the corporation.

    Dividends from such corporations are subject to Part IV tax to the extent they are the basis for a dividend refund received by the paying corporation.

11. As described in your text, the circumstances are as follows:

- A dividend is received from an unconnected company that is deductible in the calculation of the recipient's Taxable Income. While the *Income Tax Act* refers to such dividends as "assessable dividends", it is a common practice to refer to such dividends as "portfolio dividends".

- The dividend is received from a connected company, and the company paying the dividend received a refund as a consequence of making the dividend payment.

12. In general, this procedure would not be advantageous. The reason being that, if this option is chosen, the corporation has effectively used a possible permanent reduction in future taxes to acquire a reduction of Tax Payable that could otherwise ultimately be refunded. This would only make sense in situations where the non-capital loss carry forward was about to expire, or where the company did not expect to have Taxable Income in the carry forward period. With the non-capital loss carry forward period set at 20 years, this is unlikely to be a very useful strategy.

13. The RDTOH balance is made up of:

    - the refundable portion of Part I tax for the year; plus
    - the Part IV taxes paid for the year; plus
    - the corporation's RDTOH balance at the end of the preceding year; less
    - the corporation's dividend refund for the preceding year.

14. The 30-2/3 percent rate that is applied to aggregate investment income is based on the notional assumption that such income is taxed at a combined federal/provincial rate of 50-2/3 percent. Providing a 30-2/3 percent refund reduces the effective rate on this income to 20 percent. Note that this was not changed to reflect the fact that the rate that is inherent in the gross up and tax credit procedures for non-eligible dividends has been reduced from 20 percent to 14.53 percent.

    The subtraction is based on the notional assumption that foreign non-business income is only taxed in Canada at a combined federal/provincial rate of 38-2/3 percent. If the foreign tax credit is less than or equal to 8 percent, the result will reduce the rate on such income to 30-2/3 percent, the rate applicable to the refund. In these circumstances, no deduction is required.

    However, if the foreign tax credit exceeds 8 percent, the rate of Canadian tax paid on foreign non-business income falls below the refund rate of 30-2/3 percent. Given this, the formula requires that the excess of the foreign non-business tax credit over 8 percent of the foreign investment income be deducted. If this were not the case, the refund could exceed the amount of Canadian taxes paid.

15. The amount of the refund is the lesser of:

    - the balance in the RDTOH account at the end of the year; and
    - 38-1/3 percent of taxable dividends paid during the year.

16. The two most common additions to the GRIP balance of a CCPC would be:

    - 72 percent of the excess of taxable income over the sum of the amount of income that is eligible for the small business deduction plus the amount of aggregate investment income.

    - The full amount of eligible dividends received from other corporations.

17. The most common addition would probably be non-eligible dividends received from a CCPC. The other possibility would be income retained by a CCPC before it became a public company.

18. For a CCPC, the EEDD (Part III.1) tax is equal to 20 percent of the excess of the eligible dividends designated during the year, over the end-of-year balance in the CCPC's GRIP account. If the CRA concludes that the EEDD was a deliberate attempt to manipulate the CCPC's GRIP account, the rate goes to 30 percent.

19. For a public company, the EEDD (Part III.1) tax is equal to 20 percent of the lesser of the amount of the eligible dividends designated and the balance in the company's LRIP account at the point in time that the eligible dividend was paid. If the CRA concludes that the EEDD was a deliberate attempt to manipulate the company's LRIP account, the rate goes to 30 percent.

TIF Solution Thirteen - 2

New For 2016/2017

1. True. After tax rates of return are higher for eligible dividends.

2. False. If public company has an LRIP balance, any dividend declared will be a non-eligible dividend.

3. True. Aggregate investment income is reduced by any net capital losses that are deducted during the year.

4. True. The objective of the Additional Refundable Tax On Investment Income is to discourage the use of a Canadian controlled private corporation to defer taxes on investment income.

5. False. It is only assessed when the connected company has received a dividend refund as a result of paying the dividend.

6. True. The definition of a connected company includes a corporation in which the other corporation owns more than 10 percent of the voting shares, and more than 10 percent of the fair market value of all of the issued shares of the corporation.

7. False. It is reduced by the dividend refund in the preceding year.

8. True. The dividend refund for the current year cannot exceed the balance in the RDTOH account at the end of the year.

9. False. Even if the CCPC has a GRIP balance, the designation of a dividend as eligible is discretionary. There is no required designation.

10. True. A Canadian controlled private corporation's GRIP balance is reduced by dividends that were designated as eligible in the preceding taxation year.

Retained From Previous Editions

11. True.

12. False. The combined federal/provincial dividend tax credit must be equal to 100 percent of the gross up.

13. False. It is the RDTOH balance at the end of the year that is relevant.

14. False. GRIP is increased by 100 percent of eligible dividends received during the year.

TIF Solution Thirteen - 3

New For 2016/2017

1. C. The combined federal/provincial dividend tax credit will always be equal to the gross up.

2. D. Dividends from taxable Canadian companies.

3. A. It is always equal to 30-2/3 percent of aggregate investment income.

4. D. Part IV tax is assessed at a rate of 30-2/3 percent.

5. A. The balance is reduced by 38-1/3 percent of any dividends paid during the year.

6. D. A CCPC's GRIP account is increased by 72 percent of the company's Taxable Income.

Retained From Previous Editions

7. C. They can only be designated as eligible dividends by public companies.

8. B. A capital dividend.

9. D. For integration to be effective in situations where non-eligible dividends are paid, the combined federal/provincial tax rate on corporations must be equal to 14.53 percent.

10. C. The combined corporate federal and provincial tax rates must equal 14.53% for non-eligible dividends and 27.54% for eligible dividends, and the combined federal and provincial dividend tax credits must equal the gross up.

11. A. Some CCPCs have some portion of their income taxed at full rates while some non-CCPCs have some portion of their income taxed at lower rates.

12. B. If the combined corporate tax rate is equal to the benchmark rate, then the use of a corporation will result in the same amount of taxation.

13. A. If the combined dividend tax credit rate is less than 100 percent, then the use of a corporation will result in additional taxation.

14. A. $6,000 [$45,000 - $42,000 + $3,000]

15. B. Lower rates would provide a significant deferral of taxes on investment income.

16. D. Dividends from taxable Canadian corporations.

17. C. $7,040 [(10-2/3%)($45,000 + $21,000)]

18. A. $640 [(10-2/3%)($45,000 - $42,000 + $3,000)]

19. B. [($250,000 - $200,000)(30-2/3%)] = $15,333. The addition is limited by Taxable Income, less the amount eligible for the small business deduction [ITA 129(3)(a)(ii)].

20. D. It is designed to prevent the deferral of taxes on investment income that is retained by a CCPC.

21. A. Prevent tax deferral in situations where there are multiple levels of corporations in a corporate group.

22. B. A resident public corporation that is controlled largely for the benefit of an individual or a related group of individuals.

23. C. The correct answer is as follows:

Dividends Received	$20,000	
Part IV Tax Rate	38-1/3%	$7,667
Less: Non-Capital Losses Applied:		
Non-Capital Losses	($ 3,000)	
Farm Losses	(7,000)	
Subtotal	($10,000)	
Rate	38-1/3%	(3,833)
Minimum Part IV Tax		$3,834

In general, reducing Part IV tax by applying non-capital losses would only be advantageous if the losses were about to expire.

24. B. $ 32,417 [(38-1/3%)($35,000) + $15,000 + (40%)($10,000)]

25. B. The dividend will be subject to a tax of 38-1/3 percent.

26. D. The holding company will receive dividends from the operating company tax free.

27. B. $18,400 [($60,000)(30-2/3%)]

28. A. The dividend refund allows corporations with a balance in their RDTOH account to reduce their tax payable by paying dividends.

29. C. [$70,000 - (38-1/3%)($120,000) + $42,000] = $66,000

30. A. The required amount would be calculated as follows:

Balance At End Of 2015		$53,400
Taxable Income	$143,000	
Income Eligible For SBD		
($14,875 ÷ 17.5%)	(85,000)	
Aggregate Investment Income	(19,000)	
Adjusted Taxable Income	$ 39,000	
Rate	72%	28,080
Eligible Dividends Received		12,300
Eligible Dividends Designated in 2015		(13,700)
GRIP At End Of 2016		$80,080

31. A. The GRIP account is used to track balances that can be used by a CCPC as the basis for designating eligible dividends.

32. C. $163,000 [$78,000 + $85,000]

TIF Solution Thirteen - 4

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

If he incorporates, the corporation will pay taxes of $18,200 [(14%)($130,000)], leaving $111,800 to be distributed as dividends. His individual Tax Payable on these dividends would be calculated as follows:

Dividends Received	$111,800
Gross Up [(17%)($111,800)]	19,006
Grossed Up Dividends	$130,806
Tax Rate	42%
Tax Before Credit	$ 54,939
Dividend Tax Credit [(21/29 + 20%)($19,006)]	(17,564)
Tax Payable On Dividends	$ 37,375

The net after tax retention would be $74,425 ($111,800 - $37,375). This compares to $75,400 [($130,000)(1 - .42)] retained if a corporation is not used which is $975 higher. The use of a corporation is not desirable in terms of after tax returns, especially if the costs associated with maintaining a corporate entity are considered.

Exam Exercise Solution Thirteen - 2 (Integration - Non-Eligible Dividends)

If Nashwa incorporates, the corporation will pay taxes of $15,000 [(15%)($100,000)], leaving $85,000 available for paying dividends. Individual taxes on these dividends would be calculated as follows:

Dividends Received	$85,000
Gross Up [(17%)($85,000)]	14,450
Taxable Dividends	$99,450
Rate	43%
Tax Before Credit	$42,764
Dividend Tax Credit [(21/29 + 29%)($14,450)]	(14,654)
Tax Payable On Dividends	$28,110

Dividends Received	$85,000
Tax Payable	(28,110)
After Tax Retention	$56,890
Retention After Direct Receipt [($100,000)(1 - 43%)]	(57,000)
Savings (Loss) With Incorporation	($ 110)

The after tax retention with the use of a corporation is $56,890, $110 lower than the retention if the income was received directly. The use of a corporation is not desirable in terms of after tax returns, especially if the costs associated with maintaining a corporate entity are considered.

Exam Exercise Thirteen - 3 Solution (Integration - Eligible Dividends)

If she incorporates, the corporation will pay taxes of $21,000 [(28%)($75,000)], leaving $54,000 to be distributed as dividends. Her individual Tax Payable on these eligible dividends would be calculated as follows:

Dividends Received	$54,000
Gross Up [(38%)($54,000)]	20,520
Grossed Up Dividends	$74,520
Personal Tax Rate	46%
Tax Before Credit	$34,279
Dividend Tax Credit [(6/11 + 32%)($20,520)]	(17,759)
Tax Payable On Dividends	$16,520

The net after tax retention would be $37,480 ($54,000 - $16,520). This compares to $40,500 [($75,000)(1 - .46)] retained if a corporation is not used. Clearly the use of a corporation is not desirable in this situation.

Exam Exercise Solution Thirteen - 4 (Integration - Eligible Dividends)

With incorporation, corporate taxes would be $29,000 [(29%)($100,000)], leaving $71,000 available to pay dividends. Individual taxes on this would be calculated as follows:

Dividends Received	$71,000
Gross Up [(38%)($71,000)]	26,980
Grossed Up Dividends	$97,980
Personal Tax Rate	43%
Tax Before Credit	$42,131
Dividend Tax Credit [(6/11 + 29%)($26,980)]	(22,541)
Tax Payable On Dividends	$19,590

Dividends Received	$71,000
Tax Payable	(19,590)
After Tax Retention	$51,410
Retention After Direct Receipt [($100,000)(1 - 43%)]	(57,000)
Savings (Loss) With Incorporation	($ 5,590)

Exam Exercise Solution Thirteen - 5 Solution
(Additional Refundable Tax On Investment Income)

Axco's Taxable Income would be calculated as follows:

Net Income For Tax Purposes	$342,000
Dividends From Taxable Canadian Corporations	(31,000)
Net Capital Loss Carry Forward	(32,000)
Non-Capital Loss Carry Forward	(29,000)
Taxable Income	$250,000

Axco's amount eligible for the small business deduction of $226,000 is the least of active business income of $226,000, Taxable Income of $250,000, and the annual business limit of $500,000.

Given these calculations, Axco's additional refundable tax on investment income would be calculated using the lesser of:

Aggregate Investment Income		
Taxable Capital Gains	$51,000	
Net Capital Loss Deducted	(32,000)	
Interest Income	34,000	$53,000
Taxable Income	$250,000	
Amount Eligible For SBD	(226,000)	$24,000

The additional refundable tax on investment income would be $2,560 [(10-2/3%)($24,000)]. Note that the Taxable Income limit is $29,000 ($53,000 - $24,000) less than the Aggregate Investment Income. This difference is the result of the deduction of the $29,000 non-capital loss carry forward.

Exam Exercise Solution Thirteen - 6 Solution
(Additional Refundable Tax On Investment Income)

Barnum's Taxable Income would be calculated as follows:

Net Income For Tax Purposes	$436,000
Dividends From Taxable Canadian Corporations	(61,000)
Net Capital Loss Carry Forward	(47,000)
Non-Capital Loss Carry Forward	(163,000)
Taxable Income	$165,000

Barnum's amount eligible for the small business deduction of $165,000 is the least of active business income of $256,000, Taxable Income of $165,000, and the annual business limit of $250,000 [(1/2)($500,000)].

Given these calculations, Barnum's additional refundable tax on investment income would be 10-2/3 percent of the lesser of:

Aggregate Investment Income		
Taxable Capital Gains	$85,000	
Net Capital Loss Deducted	(47,000)	
Interest Income	34,000	$72,000
Taxable Income	$165,000	
Amount Eligible For SBD	(165,000)	Nil

Based on these calculations, the additional refundable tax on investment income would be nil.

Exam Exercise Solution Thirteen - 7 (Flow Through Of Investment Income)

If Mr. Fisher receives the income directly, he will retain $45,120 [($94,000)(1 - .52)]. Alternatively, if the investments are transferred to a corporation, the results would be as follows:

Corporate Investment Income	$94,000
Corporate Tax At 51 Percent	(47,940)
Income Before Dividends	$46,060
Dividend Refund [($46,060 ÷ .61667) - $46,060]	28,632
Dividends Paid To Mr. Fisher	$74,692

Non-Eligible Dividends Received	$74,692
Gross Up Of 17 Percent	12,698
Personal Taxable Income	$87,390
Personal Tax Rate	52%
Tax Payable Before Dividend Tax Credit	$45,443
Dividend Tax Credit [(21/29 + 30%)($12,698)]	(13,005)
Personal Tax Payable With Corporation	$32,438

Non-Eligible Dividends Received	$74,692
Personal Tax Payable	(32,438)
After Tax Cash Retained With Corporation	$42,254

The increase in the RDTOH of $28,827 [(30-2/3%)($94,000)] would permit the payment of a dividend refund of $28,632.

With the corporate tax rate at 51 percent, only 1 percent below the personal rate of 52 percent, there would only be limited deferral on income left in the corporation.

There would be $2,866 ($45,120 - $42,254) less retained income with the use of a corporation.

Exam Exercise Solution Thirteen - 8 (Flow Through Of Investment Income)

If the income is received directly by Ms. Fox, the after tax retention would be as follows:

Interest Received	$172,000
Personal Taxes [(53%)($172,000)]	(91,160)
After Tax Cash Retained Without Corporation	$ 80,840

The alternative results if the income is flowed through a corporation would be as follows:

Corporate Investment Income	$172,000
Corporate Tax At 50 Percent	(86,000)
After Tax Income	$ 86,000
Dividend Refund (Note)	52,747
Dividend To Ms. Fox	$138,747

Note Based on the amount of after tax income available, the maximum possible dividend would be $53,459 [($86,000 ÷ .61667) - $86,000]. However, the refund is limited by the balance in the RDTOH account. As this is a new corporation, there would be no opening balance in this account and the addition would be $52,747 [(30-2/3%)($172,000)]. Given this, the refund would be limited to $52,747.

Non-Eligible Dividends Received	$138,747
Gross Up Of 17 Percent	23,587
Taxable Dividends	$162,334
Personal Tax Rate	53%
Tax Payable Before Dividend Tax Credit	$ 86,037
Dividend Tax Credit [(21/29 + 35%)($23,587)]	(25,336)
Personal Tax Payable With Corporation	$ 60,701

Non-Eligible Dividends Received	$138,747
Personal Tax Payable	(60,701)
After Tax Cash Retained With Corporation	$ 78,046

With the high personal tax rate in this example, the use of the corporation would result in some deferral:

Taxes If Income Received Directly	$91,160
Taxes If Income Retained In Corporation	(86,000)
Deferral	$ 5,160

Overall, the use of a corporation would reduce after tax funds as follows:

After Tax Retention - Direct Receipt	$80,840
After Tax Retention - Corporate Flow Through	(78,046)
Reduction In After Tax Retention	$ 2,794

Exam Exercise Solution Thirteen - 9 (Part IV Tax)

The amount of Part IV Tax Payable would be calculated as follows:

Tax On Portfolio Investments [(38-1/3%)($21,300)]	$ 8,165
Tax On Saston Inc. Dividends	Nil
Tax On Raston Inc. Dividends [(40%)($25,000)]	10,000
Part IV Tax Payable	$18,165

Exam Exercise Solution Thirteen - 10 (Part IV Tax)

The amount of Part IV Tax Payable would be calculated as follows:

Tax On Whitewood Ltd. Dividends [(65%)($20,000)]	$13,000
Tax On Redwood Inc. Dividends	Nil
Tax On Portfolio Investments [(38-1/3%)($35,000)]	13,417
Part IV Tax Payable	$26,417

Exam Exercise Solution Thirteen - 11 (Refundable Part I Tax)

The refundable amount of Starfare Ltd.'s Part I tax would be the least of the following three figures:

Net Rental Income		$17,600
Taxable Capital Gains [(1/2)($91,500)]		45,750
Interest Income		17,450
Foreign Non-Business Income (100 Percent)		20,000
Net Capital Losses Deducted		(24,000)
Aggregate Investment Income Under ITA 129(4)		$76,800
Rate		30-2/3%
Amount Before Foreign Income Adjustment		$23,552
Less The Excess Of:		
Foreign Non-Business Tax Credit	($1,600)	
Over 8 Percent Of $20,000	1,600	Nil
ITA 129(3)(a)(i) Amount		$23,552
Taxable Income ($232,350 - $41,300 - $24,000)		$167,050
Less:		
Amount Eligible For The Small Business Deduction ($13,125 ÷ 17.5%)		(75,000)
[(100 ÷ 38-2/3)($1,600)] Foreign Non-Business Tax Credit		(4,138)
Adjusted Taxable Income		$ 87,912
Rate		30-2/3%
ITA 129(3)(a)(ii) Amount		$ 26,960
ITA 129(3)(a)(iii) Amount - Part I Tax Payable		$38,258

The least of these three amounts is $23,552, and this would be the refundable portion of Part I tax for the year.

Exam Exercise Solution Thirteen - 12 (Refundable Part I Tax)

The refundable amount of Elm's Part I tax would be calculated as follows:

Interest On Long Term Investments		$33,000
Taxable Capital Gains		88,000
Net Rental Income		26,000
Foreign Non-Business Income (100 Percent)		40,000
Net Capital Loss Deducted		(45,000)
Aggregate Investment Income		$142,000
Rate		30-2/3%
Amount Before Foreign Income Adjustment		$ 43,547
Less The Excess of:		
Foreign Non-Business Tax Credit	($4,000)	
Over 8 Percent Of $40,000	3,200	(800)
ITA 129(3)(a)(i) Amount		$ 42,747
Taxable Income ($458,000 - $83,000 - $45,000)		$330,000
Amount Eligible For The SBD ($21,875 ÷ 17.5%)		(125,000)
[(100 ÷ 38-2/3)($4,000)] Foreign Non-Business Tax Credit		(10,345)
Adjusted Taxable Income		$194,655
Rate		30-2/3%
ITA 129(3)(a)(ii) Amount		$ 59,694
ITA 129(3)(a)(iii) Amount - Part I Tax Payable		$ 73,482

The least of these three amounts is $42,747, and this would be the refundable portion of Part I tax for the year.

Exam Exercise Solution Thirteen - 13 (RDTOH Increase For The Year)

The increase in the RDTOH account would be the least of the following three figures:

Aggregate Investment Income		$60,000
Rate		30-2/3%
Amount Before Foreign Income Adjustment		$18,400
Less The Excess Of:		
Foreign Non-Business Tax Credit	($6,000)	
Over 8 Percent Of $60,000	4,800	(1,200)
ITA 129(3)(a)(i) Amount		$17,200
Taxable Income		$200,000
Less:		
Amount Eligible For The Small Business Deduction		(140,000)
[(100 ÷ 38-2/3)($6,000)] Foreign Non-Business Tax Credit		(15,517)
Adjusted Taxable Income		$ 44,483
Rate		30-2/3%
ITA 129(3)(a)(ii) Amount		$ 13,641
ITA 129(3)(a)(iii) Amount - Part I Tax Payable		$ 31,900

The least of these three amounts is $13,641, and this would be the increase in the RDTOH for the year.

Exam Exercise Solution Thirteen - 14 (Dividend Refund)

The balance in the RDTOH account of Ho Trading Company would be as follows:

RDTOH, End Of Preceding Year	$43,500
Less: Dividend Refund For Preceding Year (Given)	(6,000)
Opening Balance	$37,500
Refundable Part I Tax [(30-2/3%)($43,000)]	13,187
Part IV Tax On Portfolio Dividends [(38-1/3%)($12,350)]	4,734
Closing Balance - RDTOH	$55,421

The dividend refund would be $13,417 [(38-1/3%)($35,000)], the lesser of 38-1/3 percent of the dividends paid and the $55,421 balance in the RDTOH account.

Exam Exercise Solution Thirteen - 15 (Dividend Refund)

The RDTOH balance at the end of 2016 is calculated as follows:

RDTOH, End Of Preceding Year	$15,000
Less: Dividend Refund For Preceding Year (Given)	(12,000)
Opening Balance	$ 3,000
Refundable Part I Tax - Given	2,000
Part IV Tax Payable [(38-13%)($18,000)]	6,900
Closing Balance - RDTOH	$11,900

The dividend refund is $11,900, the lesser of the $11,900 balance in RDTOH at the end of the year, and 38-1/3 percent of taxable dividends paid or $14,950 [(38-1/3%)($39,000)].

Exam Exercise Solution Thirteen - 16 (GRIP Balance)

Since Taxable Income is greater than Aggregate Investment Income, the 2016 ending balance in GRIP will be calculated as follows:

GRIP Balance At End Of 2015		$167,000
Taxable Income	$476,000	
Income Eligible For SBD ($70,000 ÷ 17.5%)	(400,000)	
Aggregate Investment Income		
($14,000 + $7,000 - $14,000)	(7,000)	
Adjusted Taxable Income	$ 69,000	
Rate	72%	49,680
Eligible Dividends Received		17,000
Eligible Dividends Designated in 2015		(153,000)
GRIP At End Of 2016		$ 80,680

The eligible dividends paid during 2016 will be deducted from the GRIP in 2017.

Exam Exercise Solution Thirteen - 17 (GRIP Balance)

Since Taxable Income is greater than Aggregate Investment Income, the 2016 ending balance in GRIP will be calculated as follows:

GRIP Balance At End Of 2015		$375,000
Taxable Income	$726,000	
Income Eligible For SBD ($61,250 ÷ 17.5%)	(350,000)	
Aggregate Investment Income ($18,000 + $22,000 - $18,000)	(22,000)	
Adjusted Taxable Income	$354,000	
Rate	72%	254,880
Eligible Dividends Received		36,000
Eligible Dividends Designated in 2015		(290,000)
GRIP At End Of 2016		$375,880

The eligible dividends paid during 2016 will be deducted from the GRIP in 2017.

TIF Solution Thirteen - 5A

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

A. 10

B. 3

C. 4

D. 8

E. 5

F. 2

G. 7

H. 1

The two unused definitions are as follows:

Low Rate Income Pool = 6

Refundable Part I Tax = 9

TIF Solution Thirteen - 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. 13

B. 4 (not 11)

C. 5

D. 10 (not 3)

E. 6 (not 14)

F. 2 (not 7)

G. 9

H. 1

The two unused definitions are as follows:

Low Rate Income Pool = 8

Refundable Part I Tax = 12

TIF Solution Thirteen - 6

The required calculations would be as follows:

Corporate Taxes

Income For The Year	$80,000
Corporate Taxes (13%)	(10,400)
Income Available For Dividends	$69,600

Personal Taxes On Dividends

Dividend Income	$69,600
Gross Up (17%)	11,832
Taxable Dividends	$81,432
Tax Payable Before Dividend Tax Credit [(26% + 8%)($81,432)]	$27,687
Dividend Tax Credit [(21/29 + 20%)($11,832)]	(10,934)
Personal Tax Payable	$16,753

Total Taxes On Corporate Flow Through

Corporate Taxes	$10,400
Personal Taxes	16,753
Total Taxes	$27,153

Total Taxes On Income Earned Directly

Income For The Year	$80,000
Combined Federal/Provincial Tax Rate (26% + 8%)	34%
Personal Tax Payable	$27,200

The combined corporate and personal taxes are only $47 ($27,200 - $27,153) lower than the taxes that would be paid on the direct receipt of income. This result indicates that, in this example, integration is working pretty well.

This result reflects a low corporate combined tax rate of 13 percent (perfect integration requires a 14.53 percent corporate tax rate) which encourages the use of a corporation. Offsetting this is a low provincial dividend tax credit (perfect integration requires an 8/29 or 27.58 percent credit).

TIF Solution Thirteen - 7

Part IV Refundable Tax

The Part IV Tax Payable for Warron Inc. would be calculated as follows:

Dividend Refund Received By Delux Inc.	$14,400
Warron's Percentage Of Ownership	35%
Part IV Payable On Delux Inc. Dividends	$ 5,040
Part IV Tax On Power Corporation Dividends [(38-1/3%)($19,200)]	7,360
Part IV Tax Payable	$12,400

Part I Refundable Tax

The refundable portion of the Part I tax would be the least of the following amounts:

Taxable Capital Gain [(1/2)($71,200)]	$35,600
Net Rental Income	13,200
Aggregate Investment Income	$48,800
Rate	30-2/3%
ITA 129(3)(a)(i)	$ 14,965

Taxable Income	$365,100
Amount Eligible For Small Business Deduction (See Note)	(64,000)
Total	$301,100
Rate	30-2/3%
ITA 129(3)(a)(ii)	$ 92,337

ITA 129(3)(a)(iii) Part I Tax Payable - Given	$ 69,440

Note The problem states that Warron's $64,000 share of the annual business limit is less than active business income. In addition, it is less than the Company's Taxable Income. These facts establish that the amount eligible for the small business deduction is Warron's share of the annual business limit.

The refundable portion of Part I tax is equal to $14,965, which is the least of the preceding three amounts.

RDTOH

The end of year balance in the Refundable Dividend Tax On Hand account and refundable Part I tax can be calculated as follows:

RDTOH Balance - End Of The Preceding Year	$19,400
Dividend Refund For The Preceding Year	(7,100)
Opening Balance	$12,300
Part IV Tax Payable	12,400
Refundable Part I Tax	14,965
RDTOH Balance - End Of The Year	$39,665

Dividend Refund

The dividend refund will be $20,412 the lesser of:

- $20,412 (38-1/3 percent of the $53,250 in dividends paid); and
- the $39,665 balance in the RDTOH.

TIF Solution Thirteen - 8

The required calculation of Part I Tax Payable would be as follows:

Taxable Income (Given)	$227,000
Base Amount Of Part I Tax [(38%)($227,000)]	$86,260
Federal Tax Abatement [(10%)($227,000)]	(22,700)
Small Business Deduction (Note One)	(35,000)
Additional Refundable Tax On Investment Income (Note Two)	2,880
Manufacturing And Processing Profits Deduction (Note Three)	Nil
General Rate Reduction (Note Four)	Nil
Foreign Non-Business Income Tax Credit (Equal To Withholding)	(4,500)
Part I Tax Payable	$26,940

Note One There is a circular calculation involved in the calculation of foreign tax credits, the small business deduction, and the ART. This adds considerable complexity to the calculation of Tax Payable and, in most situations, the additional calculations do not influence the outcome (that would, in fact, be the case in this problem). To avoid these additional calculations, we have stated that the foreign tax credit is equal to the amount withheld.

Given the preceding assumption with respect to the foreign tax credit, the small business deduction would be equal to 17.5 percent of the least of:

1. Active Business Income (Given)		$237,000
2. Taxable Income	$227,000	
Deduct:		
[(100/28)($4,500)] Foreign Non-Business Tax Credit	(16,071)	$210,929
3. Allocated Annual Business Limit (Given)		$200,000

The least of the three figures is $200,000, resulting in a small business deduction of $35,000 [(17.5%)($200,000)].

Note Two The aggregate investment income is equal to the gross foreign investment income plus the taxable capital gain. The ITA 123.3 refundable tax (ART) is 10-2/3 percent of the lesser of:

1. Aggregate Investment Income ($30,000 + $10,000)		$40,000
2. Taxable Income	$227,000	
Deduct: Amount Eligible For The SBD	(200,000)	$27,000

The ITA 123.3 tax on aggregate investment income is $2,880 [(10-2/3%)($27,000)].

Note Three The manufacturing and processing deduction would be 13 percent of the lesser of:

1.	Canadian M & P Profits (Given)	$126,000	
	Deduct: Amount Eligible For SBD	(200,000)	Nil
2.	Taxable Income	$227,000	
	Deduct:		
	Amount Eligible For The SBD	(200,000)	
	Aggregate Investment Income (Note Two)	(40,000)	Nil

Given these calculations, the M& P deduction would be nil.

Note Four The general rate reduction is nil, calculated as follows:

Taxable Income	$227,000
Amount Eligible For The SBD	(200,000)
Amount Eligible For The M&P Deduction	Nil
Aggregate Investment Income (Note Two)	(40,000)
Full Rate Taxable Income	Nil
Rate	13%
General Rate Reduction	Nil

TIF Solution Thirteen - 9

Part A - Part I Tax Payable

The required calculations to determine Part I federal Tax Payable are as follows:

Net Income For Tax Purposes	$1,038,800
Dividends ($297,400 + $89,600)	(387,000)
Net Capital Loss Carry Forward	(12,000)
Non-Capital Loss Carry Forward	(163,400)
Taxable Income	$ 476,400

Base Amount Of Part I Tax [(38%)($476,400)]	$181,032
Federal Tax Abatement [(10%)($476,400)]	(47,640)
Small Business Deduction (Note One)	(17,500)
Additional Refundable Tax On Investment Income (Note Two)	13,376
M&P Deduction (Note Three)	(29,380)
General Rate Reduction (Note Four)	(3,250)
Part I Federal Tax Payable	$ 96,638

Note One The small business deduction is 17.5 percent of the least of the following three amounts:

1.	Active Business Income	$514,400
2.	Taxable Income (no adjustments)	$476,400
3.	Allocated Annual Business Limit	$100,000

The lowest of these figures is the Company's $100,000 share of the annual business limit. This gives a small business deduction of $17,500 [(17.5%)($100,000)].

Note Two The aggregate investment income of $125,400 is calculated as follows:

Taxable Capital Gains	$ 93,100
Net Capital Loss Carry Forward Deducted	(12,000)
Canadian Source Interest	44,300
Aggregate Investment Income	$125,400

The ITA 123.3 refundable tax (ART) is 10-2/3 percent of the lesser of:

1.	Aggregate Investment Income		$125,400
2.	Taxable Income	$476,400	
	Deduct: Amount Eligible For The SBD	(100,000)	$376,400

The ITA 123.3 tax on aggregate investment income is $13,376 [(10-2/3%)($125,400)].

Note Three The manufacturing and processing deduction would be 13 percent of the lesser of:

1.	Canadian M & P Profits (Given)	$326,000	
	Deduct: Amount Eligible For SBD	(100,000)	$226,000
2.	Taxable Income	$476,400	
	Deduct:		
	Amount Eligible For The SBD	(100,000)	
	Aggregate Investment Income (Note Two)	(125,400)	$251,000

The M&P deduction would be equal to $29,380 [(13%)($226,000)].

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

Taxable Income	$476,400
Amount Eligible For The Small Business Deduction	(100,000)
Amount Eligible For The M&P Deduction	(226,000)
Aggregate Investment Income (Note Two)	(125,400)
Full Rate Taxable Income	$ 25,000
Rate	13%
General Rate Reduction	$ 3,250

Part B - Part IV Tax Payable

The required calculation of the Part IV Tax Payable is as follows:

Portfolio Dividends [($89,600)(38-1/3%)]	$34,347
Dividend Refund To Wholly Owned Subsidiary	52,800
Total Part IV Tax Payable	$87,147

Part C - RDTOH Balance

The calculation of the ending balance in the Refundable Dividend Tax On Hand account is as follows:

RDTOH, End Of The Preceding Year	$ 12,000
Dividend Refund For The Preceding Year	Nil
Opening Balance	$ 12,000
Refundable Portion Of Part I Tax (Note Five)	38,456
Part IV Tax (See Part B)	87,147
RDTOH Balance - December 31, 2016	$137,603

Note Five Using amounts calculated in Part A, the amount of refundable Part I tax is $38,456, the least of three amounts, calculated as follows:

- Amount Under ITA 129(3)(a)(i) [(30-2/3%)($125,400)] $ 38,456
- Amount Under ITA 129(3)(a)(ii) [(30-2/3%)($476,400 - $100,000)] $115,429
- Amount Under ITA 129(3)(a)(iii) Part I Tax Payable $ 96,638

Part D - GRIP Balance

Since Taxable Income is greater than Aggregate Investment Income, the December 31, 2016 GRIP balance would be calculated as follows:

GRIP Balance At End Of 2015		$ 26,700
Taxable Income	$476,400	
Income Eligible For SBD	(100,000)	
Aggregate Investment Income	(125,400)	
Adjusted Taxable Income	$251,000	
Rate	72%	180,720
Eligible Dividends Received		89,600
Eligible Dividends Designated in 2015		Nil
GRIP At End Of 2016		$297,020

The designated eligible dividends paid in 2016 will be deducted from the GRIP balance in 2017.

Part E - Dividend Refund

The dividend refund for the year would be $50,753, the lesser of:

- 38-1/3 percent of taxable dividends paid [($132,400)(38-1/3%)] = $50,753
- Ending RDTOH Balance (Part C) = $137,603

Part F - Total Federal Tax Payable

The required calculation to determine federal Tax Payable is as follows:

Part I Tax (See Part A)	$ 96,638
Part IV Tax (See Part B)	87,147
Dividend Refund (See Part E)	(50,753)
Federal Tax Payable	$133,032

TIF Solution Thirteen - 10

Part A - Part IV Refundable Tax

The Part IV Tax Payable for Conrod Holdings Ltd. would be calculated as follows:

Dividend Refund Received By Morsal Inc.	$8,050
Conrod's Percentage Of Ownership	70%
Part IV Payable On Morsal Inc. Dividends	$5,635
Part IV Tax On Imperial Oil Dividends [(38-1/3%)($500)]	192
Part IV Tax Payable	$5,827

Part B - Part I Refundable Tax

As the interest received appears to be related to temporary balances resulting from the Company's normal business activities, it would be viewed as active business income and would not influence the following calculations.

The refundable portion of the Part I tax would be the least of the following amounts:

Aggregate Investment Income [(1/2)($9,200)]	$ 4,600
Rate	30-2/3%
ITA 129(3)(a)(i)	$ 1,411
Taxable Income	$44,000
Amount Eligible For Small Business Deduction	(10,000)
Total	$34,000
Rate	30-2/3%
ITA 129(3)(a)(ii)	$10,427
ITA 129(3)(a)(iii) Part I Tax Payable - Given	$ 9,250

The refundable portion of Part I tax is equal to $1,411, which is the least of the preceding three amounts.

Part C - RDTOH

The end of year balance in the Refundable Dividend Tax On Hand account can be calculated as follows:

RDTOH Balance - End Of The Preceding Year	$ 8,950
Dividend Refund For The Preceding Year	(4,000)
Opening Balance	$ 4,950
Part IV Tax Payable (Part A)	5,827
Refundable Part I Tax (Part B)	1,411
RDTOH Balance - End Of The Year	$12,188

Part D - Dividend Refund

The dividend refund is the lesser of:

- $3,833 - 38-1/3 percent of the $10,000 in dividends paid.
- $12,188 - The ending balance in the RDTOH.

The lesser of these two figures is $3,833.

TIF Solution Thirteen - 11

The required calculation of Part I Tax Payable would be as follows:

Taxable Income (Given)	$95,000

Base Amount Of Part I Tax [(38%)($95,000)]	$36,100
Federal Tax Abatement [(10%)($95,000)]	(9,500)
Small Business Deduction (Note One)	(15,875)
Additional Refundable Tax On Investment Income (Note Two)	457
Foreign Non-Business Income Tax Credit (Equal To Withholding)	(1,200)
Manufacturing And Processing Profits Deduction (Note Three)	Nil
General Rate Reduction (Note Four)	Nil
Part I Tax Payable	$ 9,982

Note One There is a circular calculation involved in the calculation of foreign tax credits, the small business deduction, and the ART. This adds considerable complexity to the calculation of Tax Payable and, in most situations, the additional calculations do not influence the outcome (that would, in fact, be the case in this problem). To avoid these additional calculations, we have stated that the foreign tax credit is equal to the amount withheld.

Given the preceding assumption with respect to the foreign tax credit, the small business deduction would be equal to 17.5 percent of the least of:

1.	Active Business Income		$133,000
2.	Taxable Income	$95,000	
	Deduct:		
	[(100/28)($1,200)] Foreign Non-Business Tax Credit	(4,286)	$ 90,714
3.	Annual Business Limit		$500,000

The least of the three figures is $90,714, resulting in a small business deduction of $15,875 [(17.5%)($90,714)].

Note Two The aggregate investment income is equal to the gross foreign investment income of $8,000. The ITA 123.3 refundable tax (ART) is 10-2/3 percent of the lesser of:

1.	Aggregate Investment Income		$8,000
2.	Taxable Income	$95,000	
	Deduct: Amount Eligible For The SBD	(90,714)	$4,286

The ITA 123.3 tax on aggregate investment income is $457 [(10-2/3%)($4,286)].

Note Three The manufacturing and processing deduction would be 13 percent of the lesser of:

1.	Canadian M & P Profits (Given)	$99,000	
	Deduct: Amount Eligible For SBD	(90,714)	$8,286
2.	Taxable Income	$95,000	
	Deduct:		
	Amount Eligible For The SBD	(90,714)	
	Aggregate Investment Income (Note Two)	(8,000)	Nil

Given these calculations, the M& P deduction would be nil.

Note Four The general rate reduction is nil, calculated as follows:

Taxable Income	$95,000
Amount Eligible For The SBD	(90,714)
Amount Eligible For The M&P Deduction	Nil
Aggregate Investment Income (Note Two)	(8,000)
Full Rate Taxable Income	Nil
Rate	13%
General Rate Reduction	Nil

TIF Solution Thirteen - 12

Landor Ltd.'s Taxable Income would be calculated as follows:

Net Income For Tax Purposes	$223,500
Net Capital Loss Carry Forward Deducted (All)	(5,250)
Taxable Income	$218,250

Landor Ltd.'s net federal Tax Payable would be calculated as follows:

Base Amount Of Part I Tax [(38%)($218,250)]	$82,935
Federal Tax Abatement (Note One)	(19,643)
Small Business Deduction (Note Two)	(19,250)
Additional Refundable Tax On Investment Income (Note Three)	640
Manufacturing And Processing Profits Deduction (Note Four)	(4,771)
General Rate Reduction (Note Five)	(8,522)
Foreign Tax Credit On Business Income [(10%)($28,800)]	(2,880)
Part I Tax Payable	$28,509
Dividend Refund (Note Six)	(1,840)
Net Federal Tax Payable	$26,669

Note One The abatement is based on 90 percent [(88% + 92%) ÷ 2] of Landor's income being taxed in a province. This gives a figure of $19,643 [(90%)(10%)($218,250)].

Note Two The small business deduction is 17.5 percent of the least of the following three amounts:

1. Canadian Active Business Income (Given)		$183,450
2. Taxable Income	$218,250	
Deduct: [(4)($2,880)] Business FTC	(11,520)	$206,730
3. Allocated Annual Business Limit (Given)		$110,000

The least of these figures is the Company's $110,000 share of the annual business limit, resulting in a small business deduction of $19,250 [(17.5%)($110,000)].

Note Three The aggregate investment income of $6,000 is calculated as follows:

Taxable Capital Gains	$11,250
Net Capital Loss Carry Forward Deducted	(5,250)
Aggregate Investment Income	$ 6,000

The ITA 123.3 refundable tax (ART) is 10-2/3 percent of the lesser of:

1. Aggregate Investment Income		$ 6,000
2. Taxable Income	$218,250	
Deduct: Amount Eligible For The SBD	(110,000)	$108,250

The ITA 123.3 tax on aggregate investment income is $640 [(10-2/3%)($6,000)].

Note Four The manufacturing and processing profits deduction would be 13 percent of the lesser of:

1.	M & P Profits (Given)	$146,700	
	Deduct: Amount Eligible For The SBD	(110,000)	$36,700
2.	Taxable Income	$218,250	
	Deduct:		
	Amount Eligible For The SBD	(110,000)	
	[(4)($2,880)] Foreign Business Tax Credit	(11,520)	
	Aggregate Investment Income (Note Three)	(6,000)	$90,730

The lesser of these figures is $36,700, resulting in a manufacturing and processing profits deduction in the amount of $4,771 [(13%)($36,700)].

Note Five The general rate reduction is calculated as follows:

Taxable Income	$218,250
Amount Eligible For The SBD	(110,000)
Amount Eligible For The M&P Deduction	(36,700)
Aggregate Investment Income (Note Three)	(6,000)
Full Rate Taxable Income	$ 65,550
Rate	13%
General Rate Reduction	$ 8,522

Note Six The only addition to the RDTOH account for the year would be the refundable portion of Part I tax. This amount would be the least of three figures as follows:

Aggregate Investment Income (Note Three)	$6,000
Rate	30-2/3%
Amount Under ITA 129(3)(a)(i)	$1,840

Taxable Income	$218,250
Deduct:	
Amount Eligible For Small Business Deduction	(110,000)
[(4)($2,880)] Foreign Business Tax Credit	(11,520)
Balance	$ 96,730
Rate	30-2/3%
Amount Under ITA 129(3)(a)(ii)	$ 29,664

Amount Under ITA 129(3)(a)(iii) Part I Tax Payable	$28,509

The least of these three amounts would be $1,840 and this will be the balance in the RDTOH account, given that the RDTOH balance at the end of the preceding year was nil.

The dividend refund for the year would be $1,840, the lesser of:

- 38-1/3 percent of taxable dividends paid [(38-1/3)($46,000)] = $17,633
- RDTOH balance = $1,840

TIF Solution Thirteen - 13

Part A - Net And Taxable Income

The Net Income For Tax Purposes and Taxable Income of the Gardner Distributing Company would be calculated as follows:

Pre-Tax Accounting Income		$598,000
Additions:		
Amortization Expense	$ 47,000	
Charitable Donations	15,000	
Accounting Loss On Sale Of Truck	19,000	
Taxable Capital Gain (Note One)	3,500	84,500
		$682,500
Deductions:		
Accounting Gain On Investment Sale	($ 7,000)	
Capital Cost Allowance (Note Two)	(138,900)	
Terminal Loss (Note Three)	(12,000)	(157,900)
Net Income For Tax Purposes		**$524,600**
Charitable Donations		(15,000)
Eligible Dividends Received		(27,000)
Taxable Income		**$482,600**

Note One The taxable capital gain on the investment would be calculated as follows:

Proceeds Of Disposition	$100,000
Adjusted Cost Base	(93,000)
Capital Gain	$ 7,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 3,500

Note Two The CCA can be calculated as follows:

Class 3 [(5%)($726,000)]	$ 36,300
Class 8 {[20%][$472,000 + ($82,000)(1/2)]}	102,600
Total CCA	$138,900

Note Three The only remaining asset in Class 10 was sold for $10,000. As this was $12,000 less than the UCC balance ($22,000 - $10,000), this amount becomes a terminal loss for the year.

Part B - Part I Tax Payable

The Part I federal Tax Payable can be calculated as follows:

Base Amount Of Part I Tax [(38%)($482,600)]	$183,388
Federal Tax Abatement [(10%)($482,600)]	(48,260)
Small Business Deduction (Note Four)	(84,455)
Additional Refundable Tax On Investment Income (Note Five)	Nil
General Rate Reduction (Note Six)	Nil
Part I Tax Payable	$ 50,673

Note Four The small business deduction would be equal to 17.5 percent of the least of:

1.	Active Business Income ($524,600 - $3,500 - $27,000)	$494,100
2.	Taxable Income (no foreign tax credit adjustments)	$482,600
3.	Annual Business Limit	$500,000

The least of the three figures is $482,600 and 17.5 percent of this amount is $84,455.

Note Five The aggregate investment income is equal to the taxable capital gain of $3,500. The ITA 123.3 tax on aggregate investment income (ART) is 10-2/3 percent of the lesser of:

1.	Aggregate Investment Income (Taxable Capital Gain)		$ 3,500
2.	Taxable Income	$482,600	
	Deduct: Amount Eligible For The SBD	(482,600)	$ Nil

The lesser of these amounts is Nil and 10-2/3 percent of this amount is Nil.

Note Six The general rate reduction is calculated as follows:

Taxable Income	$482,600
Amount Eligible For The SBD	(482,600)
Aggregate Investment Income (Note Five)	(3,500)
Full Rate Taxable Income	Nil
Rate	13%
General Rate Reduction	Nil

Part C - RDTOH Balance

The calculation of the ending balance in the Refundable Dividend Tax On Hand account is as follows:

RDTOH, End Of The Preceding Year	$19,000	
Dividend Refund For The Preceding Year	(5,000)	$14,000
Refundable Portion Of Part I Tax (Note Seven)	$ Nil	
Part IV Tax On Dividends Received [(38-1/3%)($27,000)]	10,350	10,350
RDTOH Balance - Ending Balance		$24,350

Note Seven Using amounts calculated in Part B, the amount of refundable Part I tax is Nil, the least of three amounts, calculated as follows:

• Amount Under ITA 129(3)(a)(i) [(30-2/3%)($3,500)]	$ 1,073
• Amount Under ITA 129(3)(a)(ii) [(30-2/3%)($482,600 - $482,600)]	Nil
• Amount Under ITA 129(3)(a)(iii) Part I Tax Payable	$50,673

Part D - Federal Tax Payable

The minimum federal Tax Payable can be calculated as follows:

Part I Tax (Part B)	$50,673
Part IV Tax On Dividends Received [(38-1/3%)($27,000)]	10,350
Dividend Refund (Note Eight)	(6,517)
Federal Tax Payable	$54,506

Note Eight The dividend refund for the year would be $6,517, the lesser of:

- 38-1/3 percent of taxable dividends paid [(38-1/3%)($17,000)] = $6,517
- RDTOH Balance - December 31, 2016 = $24,350

Part E - GRIP Balance

Since Taxable Income is greater than Aggregate Investment Income, the December 31, 2016 GRIP balance can be calculated as follows:

GRIP Balance At End Of 2015		$ 32,500
Taxable Income	$482,600	
Income Eligible For SBD	(482,600)	
Aggregate Investment Income	(3,500)	
Adjusted Taxable Income	Nil	
Rate	72%	Nil
Eligible Dividends Received		27,000
Eligible Dividends Designated in 2015		(9,600)
GRIP At End Of 2016		$49,900

The eligible dividends paid during 2016 will be deducted from the GRIP in 2017.

TIF Solution Thirteen - 14

Part A - Minimum Taxable Income

Glandly Inc.'s minimum Taxable Income would be calculated as follows:

Net Income For Tax Purposes (Given)	$563,000
Dividends From Taxable Canadian Corporations ($22,670 + $21,600)	(44,270)
Donations To Registered Charities	(49,500)
Net Capital Loss Carry Forward (Note One)	(38,250)
Non-Capital Loss Carry Forward (All)	(10,200)
Taxable Income	$420,780

Note One The deduction of the net capital loss is limited to $38,250, the amount of the Company's net taxable capital gains for the current year.

There is a net capital loss carry forward of $6,750 ($45,000 - $38,250).

Part B - Part I Tax Payable

The Part I Tax Payable is calculated as follows:

Base Amount Of Part I Tax [(38%)($420,780)]	$159,896
Federal Tax Abatement [(10%)($420,780)(87%)]	(36,608)
Small Business Deduction (Note Two)	(21,000)
Additional Refundable Tax On Investment Income (Note Three)	10,256
Manufacturing And Processing Profits Deduction (Note Four)	(8,350)
General Rate Reduction (Note Five)	(18,252)
Foreign Non-Business Income Tax Credit (Amount Withheld)	(4,500)
Foreign Business Income Tax Credit (Amount Withheld)	(4,150)
Part I Tax Payable	$77,292

Note Two The small business deduction is 17.5 percent of the least of the following three amounts:

1. Canadian Active Business Income ($184,230 + $117,100)		$301,330
2. Taxable Income	$420,780	
Deduct:		
[(100/28)($4,500)] Foreign Non-Business Tax Credit	(16,071)	
[(4)($4,150)] Foreign Business Tax Credit	(16,600)	$388,109
3. Allocated Annual Business Limit (Given)		$120,000

The least of these figures is the Company's $120,000 share of the annual business limit, resulting in a small business deduction of $21,000 [(17.5%)($120,000)].

Note Three The aggregate investment income of $96,150 is calculated as follows:

Taxable Capital Gains	$38,250
Net Capital Loss Carry Forward Deducted	(38,250)
Canadian Interest Income	78,150
Foreign Non-Business Income	18,000
Aggregate Investment Income	$96,150

The ITA 123.3 refundable tax (ART) is 10-2/3 percent of the lesser of:

1.	Aggregate Investment Income		$ 96,150
2.	Taxable Income	$420,780	
	Deduct: Amount Eligible For The SBD	(120,000)	$300,780

The ITA 123.3 tax on aggregate investment income is $10,256 [(10-2/3%)($96,150)].

Note Four The manufacturing and processing profits deduction is 13 percent of the lesser of:

1.	M & P Profits As Per ITR 5200 (Given)	$184,230	
	Deduct: Amount Eligible For The SBD	(120,000)	$ 64,230
2.	Taxable Income	$420,780	
	Deduct:		
	Amount Eligible For The SBD	(120,000)	
	[(4)($4,150)] Foreign Business Tax Credit	(16,600)	
	Aggregate Investment Income (Note Three)	(96,150)	$188,030

The lesser of these figures is $64,230, resulting in a manufacturing and processing profits deduction in the amount of $8,350 [(13%)($64,230)].

Note Five The general rate reduction is calculated as follows:

Taxable Income	$420,780
Amount Eligible For The SBD	(120,000)
Amount Eligible For The M&P Deduction	(64,230)
Aggregate Investment Income (Note Three)	(96,150)
Full Rate Taxable Income	$140,400
Rate	13%
General Rate Reduction	$ 18,252

Part C - Part IV Tax Payable

The Part IV tax will be assessed at a rate of 38-1/3 percent on the portfolio dividends. With respect to the dividends from the connected company, the Part IV tax will be equal to 100 percent of the dividend refund that was received by the wholly owned subsidiary.

The Part IV Tax Payable would be calculated as follows:

38-1/3 percent Of Portfolio Dividends Received [(38-1/3%)($22,670)]	$ 8,690
Share Of Dividend Refund Included In Dividends From Subsidiary [(100%)($6,000)]	6,000
Part IV Tax Payable	$14,690

Part D - RDTOH Balance

The refundable portion of the Part I tax would be the least of the following three amounts:

Aggregate Investment Income (Note Three)		$96,150
Rate		30-2/3%
		$29,486
Deduct Excess Of:		
Foreign Non-Business Tax Credit	($4,500)	
Over 8% Of Foreign Non-Business Income [(8%)($18,000)]	1,440	(3,060)
Amount Under ITA 129(3)(a)(i)		$26,426

Taxable Income	$420,780
Deduct:	
Amount Eligible For The Small Business Deduction	(120,000)
[(100 ÷ 38-2/3)($4,500)] Foreign Non-Business Tax Credit	(11,638)
[(4)($4,150)] Foreign Business Tax Credit	(16,600)
Total	$272,542
Rate	30-2/3%
Amount Under ITA 129(3)(a)(ii)	$ 83,580

Amount Under ITA 129(3)(a)(iii) = Part I Tax Payable	$77,292

The least of these three figures is $26,426, the amount determined under ITA 129(3)(a)(i).

The balance in the Refundable Dividend Tax On Hand account is calculated as follows:

RDTOH, End Of The Preceding Year	$193,500	
Dividend Refund For The Preceding Year	(47,300)	$146,200
Refundable Portion Of Part I Tax	$ 26,426	
Part IV Tax (Part C)	14,690	41,116
RDTOH Balance - December 31, 2016		$187,316

Part E - Dividend Refund

The dividend refund for the year would be $62,100, the lesser of:

- 38-1/3 percent of taxable dividends paid [(38-1/3%)($162,000)] = $62,100
- Ending RDTOH balance (Part D) = $187,316

Part F - GRIP Balance

Since Taxable Income is greater than Aggregate Investment Income, the December 31, 2016 GRIP balance would be calculated as follows:

GRIP Balance At End Of 2015		$ 32,400
Taxable Income	$420,780	
Income Eligible For SBD	(120,000)	
Aggregate Investment Income	(96,150)	
Adjusted Taxable Income	$204,630	
Rate	72%	147,334
Eligible Dividends Received		22,670
Eligible Dividends Designated in 2015		(26,800)
GRIP At End Of 2016		$175,604

The eligible dividends paid during 2016 will be deducted from the GRIP in 2017.

TIF Solution Thirteen - 15

Part A - Part I Tax Payable

The Part I Tax Payable is calculated as follows:

Base Amount Of Part I Tax [(38%)($245,000)]	$93,100
Federal Tax Abatement [(10%)(91%)($245,000)]	(22,295)
Small Business Deduction (Note One)	(17,500)
Additional Refundable Tax On Investment Income (Note Two)	3,840
Manufacturing And Processing Profits Deduction (Note Three)	(2,990)
General Rate Reduction (Note Four)	(11,180)
Foreign Non-Business Income Tax Credit (Equal To Amount Withheld)	(3,000)
Foreign Business Income Tax Credit (Equal To Amount Withheld)	(6,000)
Part I Tax Payable	$33,975

Note One There is a circular calculation involved in the calculation of foreign tax credits, the small business deduction, and the ART. This adds considerable complexity to the calculation of Tax Payable and, in most situations, the additional calculations do not influence the outcome (that would, in fact, be the case in this problem). To avoid these additional calculations, we have stated that foreign tax credits are equal to the amounts withheld.

Given the assumption with regard to foreign tax credits, the small business deduction would be 17.5 percent of the least of the following three amounts:

1. Canadian Active Business Income ($123,000 + $78,000)		$201,000
2. Taxable Income	$245,000	
Deduct:		
[(100/28($3,000)] Foreign Non-Business Tax Credit	(10,714)	
[(4)($6,000)] Foreign Business Tax Credit	(24,000)	$210,286
3. Allocated Annual Business Limit (Given)		$100,000

The least of these figures is the Company's $100,000 share of the annual business limit, resulting in a small business deduction of $17,500 [(17.5%)($100,000)].

Note Two The aggregate investment income of $36,000 is calculated as follows:

Canadian Taxable Capital Gains	$24,000
Net Capital Loss Carry Forward Deducted	(18,000)
Canadian Interest Income	10,000
Foreign Non-Business Income	20,000
Aggregate Investment Income	$36,000

The ITA 123.3 refundable tax (ART) is 10-2/3 percent of the lesser of:

1. Aggregate Investment Income		$ 36,000
2. Taxable Income	$245,000	
Deduct: Amount Eligible For The SBD	(100,000)	$145,000

The ITA 123.3 tax on aggregate investment income is $3,840 [(10-2/3%)($36,000)].

Note Three The manufacturing and processing profits deduction would be 13 percent of the lesser of:

1.	M & P Profits As Per ITR 5200 (Given)	$123,000	
	Deduct: Amount Eligible For The SBD	(100,000)	$23,000
2.	Taxable Income	$245,000	
	Deduct:		
	Amount Eligible For The SBD	(100,000)	
	[(4)($6,000)] Foreign Business Tax Credit	(24,000)	
	Aggregate Investment Income (Note Two)	(36,000)	$85,000

The lesser of these figures is $23,000, resulting in a manufacturing and processing profits deduction in the amount of $2,990 [(13%)($23,000)].

Note Four The general rate reduction is calculated as follows:

Taxable Income	$245,000
Amount Eligible For The SBD	(100,000)
Amount Eligible For The M&P Deduction	(23,000)
Aggregate Investment Income (Note Two)	(36,000)
Full Rate Taxable Income	$ 86,000
Rate	13%
General Rate Reduction	$ 11,180

Part B - RDTOH Balance

The refundable portion of the Part I tax would be the least of three amounts:

Aggregate Investment Income (Note Two)		$ 36,000
Rate		30-2/3%
		$ 11,040
Deduct Excess Of:		
Foreign Non-Business Tax Credit	($3,000)	
Over 8% Of Foreign Non-Business Income [(8%)($20,000)]	1,600	(1,400)
Amount Under ITA 129(3)(a)(i)		$ 9,640

Taxable Income	$245,000
Deduct:	
Amount Eligible For The Small Business Deduction	(100,000)
[(100 ÷ 38-2/3))($3,000)] Foreign Non-Business Tax Credit	(7,759)
[(4)($6,000)] Foreign Business Tax Credit	(24,000)
Total	$113,241
Rate	30-2/3%
Amount Under ITA 129(3)(a)(ii)	$ 34,727

Amount Under ITA 129(3)(a)(iii) Part I Tax Payable	$ 33,975

The least of these three figures is $9,640, the amount determined under ITA 129(3)(a)(i).

The December 31, 2016 balance in the Refundable Dividend Tax On Hand account is calculated as follows:

RDTOH, End Of The Preceding Year	$132,000	
Dividend Refund For The Preceding Year	(28,000)	$104,000
Refundable Portion Of Part I Tax	$ 9,640	
Part IV Tax Payable [(38-1/3%)($26,000)]	9,967	19,607
RDTOH Balance - December 31, 2016		$123,607

Part C - Dividend Refund

The dividend refund for the year would be $47,533, the lesser of:

- 38-1/3 percent of taxable dividends paid [(38-1/3%)($124,000)] = $47,533
- RDTOH Balance - December 31, 2016 = $123,607

Part D - Federal Tax Payable

The minimum federal Tax Payable can be calculated as follows:

Part I Tax (Part A)	$33,975
Part IV Tax On Dividends Received [(38-1/3%)($26,000)]	9,967
Dividend Refund (Part C)	(47,533)
Federal Tax Payable (Refund)	($ 3,591)

Part E - GRIP Balance

Since Taxable Income is greater than Aggregate Investment Income, the ending GRIP balance would be calculated as follows:

GRIP Balance At End Of 2015		$114,000
Taxable Income	$245,000	
Income Eligible For SBD	(100,000)	
Aggregate Investment Income	(36,000)	
Adjusted Taxable Income	$109,000	
Rate	72%	78,480
Eligible Dividends Received		26,000
Eligible Dividends Designated in 2015		(72,000)
GRIP At End Of 2016		$146,480

The eligible dividends paid during 2016 will be deducted from the GRIP in 2017.

Chapter Fourteen Test Item File Solutions

TIF Solution Fourteen - 1

1. There are many companies that have accumulated loss carry forwards that they have no hope of realizing. This situation is of concern to the government in that there are billions of dollars of such benefits available in the economy at any point in time. If access to these benefits was relatively trouble-free, the cost to the government in lost tax revenues could be enormous. As a consequence, the government has enacted legislation which significantly restricts the use of loss carry forwards in situations where there has been an acquisition of control.

2. IT-302R3, which deals with the losses of a corporation, indicates that control requires ownership of shares that carry with them the ability or right to elect a majority of the board of directors. An acquisition of control occurs when some event results in a taxpayer (or group) who did not have control of the corporation acquires sufficient ownership rights so that they have control. A common event of this type would be a majority shareholder selling all his shares to an arm's length person. Other answers are possible.

3. As the use of losses will be restricted after the acquisition of control, this rule prevents losses from being used prior to the normal end of the taxation year in which the acquisition of control took place.

4. The basic tax consequences of an acquisition of control are as follows:

   - There is a deemed year end at the time the acquisition of control occurs.
   - There are special rules requiring the write down of assets to fair market value at the deemed year end.
   - With respect to non-capital losses, they can only be used in years subsequent to the acquisition of control to offset profits that have occurred from operating in the same or a similar line of business. There are similar restrictions on the use of pre-acquisition of control investment tax credits.
   - With respect to net capital losses, including allowable business investment losses, they cannot be carried forward to years subsequent to the acquisition of control. In addition, if there are capital gains in the three years before the deemed year end, capital losses from years subsequent to the deemed year end cannot be carried back to those years.
   - Unused charitable deductions cannot be carried forward to years subsequent to the acquisition of control. In addition, no deduction is available on a gift made subsequent to the acquisition of control if the gifted property was acquired prior to the acquisition date in anticipation of the acquisition of control.

5. The ITA 111(4)(e) election is clearly desirable when there are:

   - unused charitable donations,
   - unused net capital losses from previous years;
   - a net allowable capital loss in the current year; or
   - unused allowable business investment losses.

   If these items are not used in the taxation year created by the deemed year end, they will be lost forever.

   With respect to non-capital losses from previous or current years, the desirability of the election will depend on whether the company believes they can be used in future years against profits in the same line of business during the relevant carry forward period.

6. It is the intent of the government to limit the availability of the small business deduction to an amount of active business income not exceeding $500,000. In the absence of special rules, the owner of a corporation with $1,000,000 in active business income could easily split that corporation into two corporations with $500,000 each in active business income. In the absence of special rules, this would mean that the taxpayer would get the small business deduction on $1,000,000 in active business income. The associated company rules prevent this from happening by requiring that these two companies would have to share a single $500,000 limit.

7. Such shares generally have the following characteristics:

    - An absence of voting rights.
    - A fixed dividend rate.
    - A specified redemption amount.

    Such shares are normally referred to as preferred shares.

8. ITA 256(1.2)(a) defines a group as simply two or more persons, each of whom owns shares in the corporation in question. This would include corporations, individuals, and trusts. There is no requirement that they be related.

9. For purposes of applying the associated company rules, control is defined as follows:

    Control A corporation is deemed to be controlled by another corporation, a person, or a group of persons, if the corporation, person, or group of persons owns either:

    - shares (common and/or preferred) of capital stock with a fair market value of more than 50 percent of all issued and outstanding shares of capital stock; or
    - common shares with a fair market value of more than 50 percent of all issued and outstanding common shares.

10. This deeming provision requires that rights to acquire shares be treated as though they were exercised for purposes of determining associated companies.

11. Investment tax credits can limit their benefits to very specific types of activity or regions of Canada. For example, the child care spaces tax credit provides benefits only to those taxpayers that incur costs to provide additional child care spaces. In contrast, general rate reductions are usually available to all taxpayers, without regard to the type of activity they are involved in or the region of Canada in which they operate. Choosing between these two types of tax benefits would be based on whether the government wished to achieve a specific objective (e.g., assistance to manufacturers in the Yukon) or, alternatively, provide general tax relief to corporations.

12. It is favourable because the deduction that is being given up has a value equal to the amount of the deduction multiplied by the taxpayer's tax rate. For example, if a corporation with a tax rate of 25 percent gives up a $1,000 deduction, the cost is only $250 [($1,000)(25%)]. In contrast, the credit is a direct reduction in Tax Payable. A $1,000 credit would be worth $1,000, regardless of the corporation's tax rate.

13. The following types of taxpayers are eligible for refundable investment tax credits:

    - an individual;
    - a "qualifying corporation", which is a Canadian controlled private corporation throughout the year with Taxable Income in the previous year of $500,000 or less before loss carry backs; or
    - a trust where each beneficiary is an individual or a qualifying corporation.

14. Investment tax credits are deducted from the capital cost of depreciable assets in the year following receipt. This means that there will no effect on CCA in the year the credit is received. In subsequent years, the capital cost of the depreciable asset will be reduced by the amount of the credit, thereby reducing CCA in subsequent years.

15. Per share PUC is based on the total amount of consideration received by the issuing corporation for the shares, divided by the total number of shares issued and outstanding. It is an average value that, at a given point in time, is the same for all issued and outstanding shares of a particular class.

    Per share ACB, in contrast, is shareholder specific. It is based on the average amount paid by that investor for the shares he owns. If all of the shares of a corporation are issued to a single individual at one point in time, the PUC and ACB would be the same for all shares.

    While this might be the situation for a private company (e.g., a CCPC issues all of its shares to a single individual and this individual has retained these shares from the commencement date of the corporation), it would be very unusual for a large public company. While the PUC for all shares of a particular class will be the same, each open market purchase will create a new and unique adjusted cost base for that individual's shares. It would be very rare for this new adjusted cost base to be equal to the PUC of the shares acquired.

16. It is the intent of the government to allow certain types of income to be received on a tax free basis by all taxpayers. While there are other types of income that fall into this category, the most important example of this type of income is the non-taxable one-half of capital gains. When such amounts are earned by a private corporation, a special mechanism is required to allow the corporation to distribute the funds to its shareholders without the amounts losing their tax free status. The capital dividend account is that mechanism. Eligible income amounts, such as one-half of capital gains and losses earned by the corporation, are added to or deducted from this account. To the extent there is a balance in this account, the corporation can elect to distribute such amounts to shareholders as a tax free capital dividend.

17. A stock dividend is a pro rata distribution of new shares to existing shareholders of a corporation. For the corporation, this will generally involve an increase in the PUC of the company's shares to the extent of the fair market value of the new shares issued. To the extent that the company has increased the PUC of its shares, such dividends will be treated as taxable dividends to the recipients. For individuals, stock dividends will be subject to either the eligible or non-eligible dividend gross up and tax credit procedures. The total adjusted cost base of the new shares will be equal to the amount of the stock dividend declared.

18. This type of transaction generates an increase in PUC that is larger than the related increase in net assets. Because PUC represents an amount that can be distributed to shareholders on a tax free basis, a benefit results from this transaction. This benefit is treated as a deemed dividend under ITA 84(1). As PUC amounts are averaged over all shares, the deemed dividend is allocated to all of the company's shareholders, not just those receiving the new shares. Reflecting this taxable benefit, the adjusted cost base of all of the shares is increased by a corresponding amount.

19. To the extent of the PUC of the shares, the distribution will be received tax free. However, the excess of the distribution over the PUC of the shares will be treated as a deemed dividend. This deemed dividend is further subdivided as follows:

    - To the extent that the corporation has a balance in its capital dividend account, part of the distribution will be considered a separate capital dividend, which will be received on a tax free basis under ITA 83(2). This treatment will only apply if an appropriate election is made.
    - To the extent that the company has a pre-1972 capital surplus on hand account, the balance will be deemed not to be a dividend.
    - Any remaining amount of the deemed dividend will be treated as a taxable dividend under ITA 84(2), subject to either the eligible or non-eligible dividend gross up and tax credit procedures.

20. This is accomplished through the ITA 54 definition of the proceeds of disposition to be used in determining the capital gain. Under this definition, any amount that has been treated as an ITA 84(3) deemed dividend is removed from the proceeds of disposition for purposes of determining any capital gain on the transaction.

TIF Solution Fourteen - 2

New For 2016/2017

1. True.

2. False. The corporation is permitted to elect a new year end after an acquisition of control. This could provide for a full year fiscal period.

3. True.

4. False. A group is any two or more persons who hold shares in a corporation. They do not have to be related.

5. True.

6. False. Credits related to capital expenditures will be deducted from the related UCC in the following year.

7. True.

8. True.

9. False. To the extent that there is an increase in PUC as the result of the dividend, there is an increase in the Net Income For Tax Purposes of shareholders.

10. False. If there is a difference between the tax value and the fair market value of the assets distributed, there will be tax consequences for the corporation.

Retained From Previous Editions

11. True. Unused net capital losses cannot be used in periods subsequent to an acquisition of control.

12. False. The addition will be $25,000 [(1/2)($250,000 - $200,000)]

13. False. Under ITA 84(3), the difference will be treated as a deemed dividend.

14. True.

TIF Solution Fourteen - 3

New For 2016/2017

1. B. Farm losses. While they would not be lost, they could only be applied in future periods to the extent farm income was present.

2. B. Flour and Yeast are associated.

3. A. The total credit would be $239,750 [($685,000)((35%)]. The refundable amount would be $239,750.

4. B. $4,665
PUC Per Share = $9.33 {[(10,000)($8) + (10,000)($9) + (10,000)($11)] ÷ 30,000]
Mark's PUC = $4,665 [(500)($9.33)]

5. C. A dividend will be taxable to the extent that the corporation has increased its PUC in the process of declaring the dividend.

6. C. A dividend in kind can result in a capital gain for the declaring corporation.

7. D. $28,400 ($23,400 + $5,000)

Proceeds Of Redemption [(10,000)($10.00)]	$100,000
PUC [(10,000)($8.00)]	(800,000)
ITA 84(3) Deemed Dividend	$ 20,000
Gross Up [(17%)($20,000)]	3,400
Taxable Dividend	$ 23,400

Proceeds Of Disposition[(10,000)($10.00)]	$100,000
ITA 84(3) Deemed Dividend	(20,000)
Adjusted Proceeds Of Disposition	$80,000
Adjusted Cost Base [(10,000)($7.00)]	(70,000)
Capital Gain	$ 10,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 5,000

Retained From Previous Editions

8. B. The inability to deduct non-capital losses subsequent to the acquisition of control.

9. B. 15% + 36% = 51%.

10. C. Subsequent to the deemed year end, non-capital losses can be deducted against any type of income.

11. A. The corporate tax rate must be prorated for the shortened year.

12. C. The losses cannot be applied in any shortened year ends that occur as a result of the acquisition of control.

13. A. None. Because the loss was generated from the operations of the catering business, which did not earn a profit in 2017.

14. C. $2,500,000 [$4 million - $1.5 million]

15. B. Hagrid Inc. will be required to write the land down to its fair market value and recognize the allowable capital loss of $42,500 at the end of 2016. A deemed disposition of the depreciable asset should be elected at a value of $185,000, resulting in recapture of $25,000 and a taxable capital gain of $42,500.

16. C. Non-capital losses arising prior to the change in control may be applied against income earned by the business that incurred the loss as long as the loss has not expired.

17. C. Hughes and ARC are associated, and Jimbo and ARC are associated.

 Hughes and ARC are associated under ITA 256(1)(a). Hughes controls Arc

 Jimbo and ARC - Mr. Hanes is deemed to own 32% [(40%)(80%)] of ARC and his daughter-in-law is deemed to own 4% [(5%)(80%)] of ARC by the look through rules in ITA 256(1.2)(d). When added to the 15% that the daughter-in-law owns outright, a related group owns 51% (32% + 4% + 15%) of ARC. The corporations are associated by ITA 256(1)(d) since Mr. Hanes controls Jimbo, a related group controls ARC, and Mr. Hanes is deemed to own greater than 25% of ARC.

18. C. A Ltd. and B Ltd. are associated under ITA 256(1)(b) as they are controlled by the same group (Amos and his brother). The fact that they are related is not relevant.

19. C. Wonder and Speedy are associated in that they are both associated with Scarlet. They would normally share the $500,000 small business deduction limit. However, since they are associated solely by virtue of their mutual association with the third corporation, the third corporation can elect not to be associated with them. With this election, the two corporations are eligible for the full $500,000 small business deduction, for a total of $1,000,000. As a consequence of making this election, Scarlet is deemed to have an annual business limit of nil.

20. B. Mr. and Mrs. G each own 50% of the shares of W Corp. Their adult children, Girl F and Boy F, each own 40% of V Corp. Mrs. G owns the remaining 20% of the shares.

21. A. The company will receive investment tax credits of $206,000. ITC = [10%][(3)($20,000) + $2,000,000]. CCA will be based on additions to qualified property of $2,000,000. The ITC will reduce the UCC in the following year.

22. B. $ 2,700,000 [$8 million – (10)($500,000) x (($40 million – ($14 million - $10 million))/$40 million]

23. D. If she were to sell the Torin shares for $4,000, she would have a deemed dividend of $500.

24. B. Dividends received from other taxable Canadian corporations.

25. C. $173,000 [$150,000 + $50,000 - $30,000 + $35,000 - $32,000]

26. D. LRIP

27. D. While the components may be different, retained earnings will have the same value in both tax based shareholders' equity and in GAAP based financial statements.

28. D. All of the above.

29. B. Sico has Taxable Income of $8,000 and Mark has Taxable Income of $84,240.

30 B. Redeeming shares for $350,000. The PUC of the shares was $350,000 and the adjusted cost base was $250,000. There is no deemed dividend as the proceeds are equal to the PUC.

31. D. $960,000 ($585,000 + $375,000). These amounts would be calculated as follows:

Proceeds Of Redemption	$3,500,000
PUC [(10%)($30,000,000)]	(3,000,000)
ITA 84(3) Deemed Dividend	$ 500,000
Gross Up [(17%)($500,000)]	85,000
Taxable Dividend	$ 585,000

Proceeds Of Disposition	$3,500,000
ITA 84(3) Deemed Dividend	(500,000)
Adjusted Proceeds Of Disposition	$3,000,000
Adjusted Cost Base	(2,250,000)
Capital Gain	$ 750,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 375,000

32. C. A corporation issues shares to a creditor in order to settle debt with a carrying value less than the PUC of the newly issued shares.

33. B. There will be a deemed dividend which will be allocated to all shareholders including the new shareholder who acquired shares by giving up debt securities. The adjusted cost base of the shares will increase by the amount of the deemed dividend.

34. D. $ 340,000. [$350,000 - $10,000]

35. B. $3,400,000. [Deemed dividend = $1,000,000 - $600,000 = $400,000. ACB will be reduced by $600,000 from $4,000,000 to $3,400,000]

36. A. The shareholders of TTT Ltd. will be deemed to have received a dividend of $10,000.

TIF Solution Fourteen - 4

Exam Exercise Solution Fourteen - 1 (Acquisition Of Control)

For the year ending December 31, 2015, Net Income For Tax Purposes and Taxable Income would be nil, without regard to whether there was an acquisition of control. A non-capital loss carry forward of $79,400 ($104,000 - $24,600) would remain at the end of the year.

No Acquisition Of Control If there was no acquisition of control, the entire $79,400 non-capital loss carry forward could be deducted. For the year ending December 31, 2016, Taxable Income would be as follows:

Net Income For Tax Purposes ($133,400 + $21,250)	$154,650
Loss Carry Forward From 2015 (All)	(79,400)
Taxable Income	$75,250

Acquisition Of Control There would be a deemed year end on December 31, 2015, the day before the acquisition of control. However, as this is the usual year end, there would be no tax consequences. In the year ending December 31, 2016, the loss carry forward could only be used to the extent of the profits in the engineering services business. Taxable Income would be calculated as follows:

Net Income For Tax Purposes ($133,400 + $21,250)	$154,650
Loss Carry Forward From 2015 (Limited To $21,250)	(21,250)
Taxable Income	$133,400

This would leave a non-capital loss carry forward of $58,150 ($79,400 - $21,250).

Exam Exercise Solution Fourteen - 2 (Acquisition Of Control)

For the year ending December 31, 2015, Net Income For Tax Purposes and Taxable Income would be nil, without regard to whether there was an acquisition of control. A non-capital loss carry forward of $103,000 ($146,000 - $43,000) would remain at the end of the year.

No Acquisition Of Control If there was no acquisition of control, the entire loss carry forward could be deducted. For the year ending December 31, 2016, Taxable Income would be as follows:

Net Income For Tax Purposes ($56,000 + $85,000)	$141,000
Loss Carry Forward From 2015 (All)	(103,000)
Taxable Income	$ 38,000

Acquisition Of Control There would be a deemed year end on December 31, 2015, the day before the acquisition of control. However, as this is the usual year end, there would be no tax consequences. In the year ending December 31, 2016, the loss carry forward could only be used to the extent of the profits in the mail order operation. Taxable Income would be calculated as follows:

Net Income For Tax Purposes ($56,000 + $85,000)	$141,000
Loss Carry Forward From 2015 - Limited To Income In The Mail Order Operation	(56,000)
Taxable Income	$ 85,000

This would leave a non-capital loss carry forward of $47,000 ($103,000 - $56,000).

Exam Exercise Solution Fourteen - 3 (Election On Acquisition Of Control)

It would clearly be desirable to elect to have a deemed disposition of the non-depreciable assets. This could be achieved by electing to have a deemed disposition of the non-depreciable assets for $740,000. This would result in a $65,000 taxable capital gain [(1/2)($740,000 - $610,000)] on the deemed disposition. This will leave $60,000 ($125,000 - $65,000) of the net capital loss carry forward.

This $60,000 could be eliminated by electing to have a deemed disposition of the depreciable property at an elected value of $495,000. This election would produce the required taxable capital gain of $60,000 [(1/2)($495,000 - $375,000)]

The election would also produce recapture of $95,000 ($375,000 - $280,000). As this is $4,000 ($95,000 - $91,000) greater than the operating loss, this would result in Taxable Income and Tax Payable. However, the ability to use the remaining $60,000 net capital loss carry forward is probably worth the cost of the Tax Payable on the extra $4,000 of income. In addition, the election would increase future CCA deductions.

Exam Exercise Solution Fourteen - 4 (Election On Acquisition Of Control)

With a net capital loss balance of $175,000, it would clearly be desirable to elect to have a deemed disposition of the non-depreciable property at fair market value. This will create a taxable capital gain of $98,000 [(1/2)($950,000 - $754,000), and leave a net capital loss balance of $77,000 ($175,000 - $98,000).

If an election at fair market value is also made on the depreciable property, the result will be a taxable capital gain of $61,000 [(1/2)($612,000 - $490,000)], as well as recapture of $165,000. This would reduce the net capital loss balance to $16,000 ($77,000 - $61,000), and eliminate the $143,000 operating loss for the period January 1, 2016 through April 30, 2016. However, it would leave $22,000 ($165,000 - $143,000) in Taxable Income and require the payment of some taxes for this short fiscal period.

It is likely that, in most situations, management would conclude that the benefits of using a large portion of the net capital loss which will expire, and avoiding a carry forward of the operating loss, would be worth the cost of the extra taxes that would be paid on $22,000 of operating income. In addition, the election would increase future CCA deductions.

Exam Exercise Solution Fourteen - 5 (Associated Companies)

Anderson Inc. and BDO Ltd. These Companies are associated under ITA 256(1)(d) as follows:

- John Anderson controls Anderson Inc.
- John Anderson is related to each member of the group that controls BDO Ltd.
- John Anderson owns not less than 25 percent of the shares of BDO Ltd.

Copper Inc. and BDO Ltd. These companies are associated under ITA 256(1)(e) as follows:

- Each corporation is controlled by a related group (Copper Inc. by Mr. and Mrs. Copper, BDO Ltd. by Mr. and Mrs. Anderson and Mrs. Copper).
- Each of the members of one of the related groups was related to all of the members of the other related group.
- One person (Mrs. Copper) who is a member of both related groups owns at least 25 percent of the shares of each corporation.

They are also associated under ITA 256(1)(b) as both Companies are controlled by the same group (Mr. and Mrs. Copper).

Anderson Inc. and Copper Inc. Provided they do not elect to not be associated, these Companies are associated under ITA 256(2) as they are both associated with a third corporation, BDO.

Exam Exercise Solution Fourteen - 6 (Associated Companies)

With 80 percent ownership, Sarah clearly controls Kern Ltd. In addition, she also controls Lorne Inc. as per the following calculation:

Direct Interest	5 Percent
Indirect Income Through Control Of Kern Ltd.	30 Percent
Deemed Interest (Daughter's Shares)	25 Percent
Total Interest	60 Percent

As both Companies are controlled by the same person, Kern Ltd. and Lorne Inc. are associated under ITA 256(1)(b).

Exam Exercise Solution Fourteen - 7 (Investment Tax Credit Procedures)

With respect to the $460,000 in current expenditures, there will be a $46,000 [(10%)($460,000)] credit against 2016 Tax Payable. This $46,000 credit will be added to income in 2017.

With respect to the $675,000 in capital expenditures, there will be a 2016 credit against Tax Payable of $67,500 [(10%)($675,000)].

The $67,500 credit will not influence the calculation of 2016 CCA. This amount will be $101,250 [(30%)(1/2)($675,000)].

In 2017, the $67,500 credit will be deducted from the January 1, 2017 UCC, leaving a balance of $506,250 ($675,000 - $101,250 - $67,500). Given this, 2017 CCA will be $151,875 [(30%)($506,250)].

Exam Exercise Solution Fourteen - 8 (Investment Tax Credit Procedures)

The $722,000 in current expenditures will generate an investment tax credit of $72,200 [(10%)($722,000)] to be deducted from the 2016 Tax Payable. The $72,200 credit will be added back to income in 2017.

The $942,000 in capital expenditures will generate an investment tax credit of $94,200 [(10%)($942,000)]. This will not be deducted from the capital cost of the acquired assets until 2017. Given this, 2016 CCA would be $94,200 [(1/2)(20%)($942,000)].

In 2017, the $94,200 credit will be subtracted, leaving a UCC balance of $753,600 ($942,000 - $94,200 - $94,200). Based on this, the 2017 CCA will be $150,720 [(20%)($753,600)].

Exam Exercise Solution Fourteen - 9 (Refundable Investment Tax Credits)

As Future Ventures has Taxable Income of less than $500,000 in the previous year, and its Taxable Capital Employed in Canada is less than $10 million, the Company's annual expenditure is not reduced from the maximum value of $3,000,000.

Given the $3,000,000 annual expenditure limit for the 35 percent rate, the total amount of investment tax credits available can be calculated as follows:

Qualified Property [(10%)($132,000)]	$ 13,200
SR&ED Current Expenditures [(35%)($1,060,000)]	371,000
Total Available Amount	$384,200

The refund available would be as follows:

Qualified Property [(40%)($13,200)]	$ 5,280
SR&ED Current Expenditures [(100%)($371,000)]	371,000
Total Refund Available	$376,280

The non-refunded investment tax credit of $7,920 ($384,200 - $376,280) can be carried forward 20 years to be applied against Tax Payable. There was no Tax Payable in the last three years so it cannot be carried back.

The cost of the qualified property will be reduced in the following year by the refundable investment tax credit of $5,280. The refundable investment tax credit on current expenditures of $371,000 will be added to income in the following year.

Exam Exercise Solution Fourteen - 10 (Refundable Investment Tax Credits)

As Forward Ltd. has Taxable Income of less than $500,000 in the previous year, and its Taxable Capital Employed in Canada is less than $10 million, the Company's annual expenditure is not reduced from the maximum value of $3,000,000.

Given the $3,000,000 annual expenditure limit for the 35 percent rate, the total amount of investment tax credits available can be calculated as follows:

Qualified Property [(10%)($220,000)]	$ 22,000
SR&ED Current Expenditures [(35%)($1,450,000)]	507,500
Total Available Amount	$529,500

The refund available would be as follows:

Qualified Property [(40%)($22,000)]	$ 8,800
SR&ED Current Expenditures [(100%)($507,500)]	507,500
Total Refund Available	$516,300

The non-refunded investment tax credit of $13,200 ($529,500 - $516,300) can be carried forward 20 years to be applied against Tax Payable. There was no Tax Payable in the last three years so it cannot be carried back.

The cost of the qualified property will be reduced in the following year by the refundable investment tax credit of $8,800. The refundable investment tax credit on current expenditures of $507,500 will be added to income in the following year.

Exam Exercise Solution Fourteen - 11 (ACB And PUC)

The adjusted cost base of the shares would be determined as follows:

	Number of Shares	Cost/Share	Total Cost
First Purchase	1,350	$ 5.60	$ 7,560
Second Purchase	4,230	$10.15	42,935
Totals	5,580		$50,495

The adjusted cost base per share would be $9.05 ($50,495 ÷ 5,580).

The PUC for the investor's shares would be calculated as follows:

	Number of Shares	PUC/Share	Total PUC
First Sale	123,000	$5.60	$ 688,800
Second Sale	32,000	$8.62	275,840
Third Sale	81,000	$10.15	822,150
Total PUC Of Outstanding Shares	236,000		$1,786,790

Number Of Shares (From First Table)	5,580
PUC Per Share [$1,786,790 ÷ 236,000 Shares]	$ 7.57
PUC For Investor's Shares	$42,241

Exam Exercise Solution Fourteen - 12 (ACB And PUC)

The adjusted cost base of the shares would be determined as follows:

	Number of Shares	Cost/Share	Total Cost
First Purchase	10,000	$16.00	$160,000
Second Purchase	5,000	$18.00	90,000
Totals	15,000		$250,000

The adjusted cost base per share would be $16.67 ($250,000 ÷ 15,000).

The PUC for the investor's shares would be calculated as follows:

	Number of Shares	PUC/Share	Total PUC
2015 Sale	400,000	$16.00	$6,400,000
2016 Sale	160,000	$18.00	2,880,000
Total PUC Of Outstanding Shares	560,000		$9,280,000

Number Of Shares (From First Table)	15,000
PUC Per Share [$9,280,000 ÷ 560,000 Shares]	$ 16.57
PUC For Investor's Shares	$248,550

Exam Exercise Solution Fourteen - 13 (Capital Dividend Account)

The balance in the capital dividend account as at December 31, 2016 would be as follows:

2005 Capital Gain [(1/2)($129,000 - $105,000)]	$12,000
2006 Capital Loss [(1/2)($83,000 - $91,000)]	(4,000)
2016 Capital Dividend Received	10,600
2016 Sale Of Goodwill [(3/4)($50,000 - $39,500)(2/3)]	5,250
2016 Capital Dividend Paid	(13,750)
Balance - End Of 2016	$10,100

Exam Exercise Solution Fourteen - 14 (Capital Dividend Account)

The balance in the capital dividend account as at December 31, 2016 would be as follows:

2005 Capital Dividend Received	$23,000
2008 Capital Gain [(1/2)($199,000 - $156,000)]	21,500
2010 Sale Of Franchise [(3/4)($150,000 - $125,000)(2/3)]	12,500
2011 Capital Loss [(1/2)($102,000 - $120,000)]	(9,000)
2016 Capital Dividends Paid	(10,400)
Balance - End Of 2016	$37,600

Exam Exercise Solution Fourteen - 15 (Stock Dividends)

Jerry will receive 100 new shares [(10%)(1,000)] with a fair market value of $2,700 [(100)($27)]. This $2,700 non-eligible dividend will be grossed up to a taxable amount of $3,159 [($2,700)(117%)]. As a result, his Net Income For Tax Purposes will increase by $3,159. The receipt of this dividend will generate a credit against Jerry's federal Tax Payable of $332 [(21/29)(17%)($2,700)].

Prior to the stock dividend, the adjusted cost base of Jerry's shares was $17,000 [(1,000)($17)]. The $2,700 dividend will be added to this amount, resulting in a new adjusted cost base of $19,700. When the 100 new shares are added to his total holding, the adjusted cost base per share will be $17.91 ($19,700 ÷ 1,100).

Exam Exercise Solution Fourteen - 16 (Stock Dividends)

Jason will receive 25 [(5%)(500)] new shares with a fair market value of $450 [(25)($18)]. This will be grossed up to a taxable amount of $527 [(117%)($450)]. This amount will be included in Jason's Net Income For Tax Purposes. In addition, he will have a credit against his federal tax payable of $55 [(21/29)(17%)($450)].

Prior to the stock dividend, Jason's shares had an adjusted cost base of $7,500 [(500)($15)]. The $450 dividend will be added to this amount, resulting in a new adjusted cost base of $7,950. His total number of shares will be 525 (500 + 25), resulting in a per share adjusted cost base of $15.14 ($7,950 ÷ 525).

Exam Exercise Solution Fourteen - 17 (Dividends In Kind)

For Boucher Inc., the results will be as follows:

Proceeds Of Disposition [(45,000)($42)]	$1,890,000
Adjusted Cost Base [(45,000)($33)]	(1,485,000)
Capital Gain	$ 405,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 202,500

The results for Martine Cloutier will be as follows:

Dividend Received [(23%)(45,000)($42)]	$434,700
Gross Up [(17%)($434,700)]	73,899
Taxable Dividend	$508,599
Dividend Tax Credit [(21/29)(17%)($434,700)]	$ 53,513

Boucher Inc.'s Net Income For Tax Purposes would be increased by the $202,500 taxable capital gain. Martine's Net Income For Tax Purposes would be increased by the taxable dividend of $508,599. Her federal Tax Payable would be decreased by the dividend tax credit of $53,513.

Exam Exercise Solution Fourteen - 18 (Dividends In Kind)

For Topex Ltd, the results will be as follows:

Proceeds Of Disposition [(62,000)($8.50)]	$527,000
Adjusted Cost Base	(372,000)
Capital Gain	$155,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 77,500

The results for the shareholder will be as follows:

Dividend Received [(10%)($527,000)]	$52,700
Gross Up [(17%)($52,700)]	8,959
Taxable Dividend	$61,659
Dividend Tax Credit [(21/29)(17%)($52,700)]	$ 6,488

Topex Ltd.'s Net Income For Tax Purposes would be increased by the $77,500 taxable capital gain. The shareholder's Net Income For Tax Purposes would be increased by the taxable dividend of $61,659. Federal Tax Payable would be decreased by the dividend tax credit of $6,488.

Exam Exercise Solution Fourteen - 19 (ITA 84(1) Deemed Dividend)

This transaction will result in an ITA 84(1) deemed dividend for all shareholders, calculated as follows:

PUC Of New Shares [(43,000)($12.05)]	$518,150
Increase In Net Assets	(505,000)
ITA 84(1) Deemed Dividend	$ 13,150

This would be allocated to all 174,000 (131,000 + 43,000) shares outstanding, on the basis of $0.08 per share. This would be a taxable dividend, subject to either the eligible or non-eligible dividend gross up and tax credit procedures. The $0.08 per share dividend would be added to the adjusted cost base of all 174,000 shares.

With the addition of $0.08, the new adjusted cost base of Mr. Scott's shares would be $11.33 ($11.25 + $0.08) per share. The taxable capital gain on their disposition would be calculated as follows:

Proceeds Of Disposition [(7,000)($14.36)]	$100,520
Adjusted Cost Base [(7,000)($11.33)]	(79,310)
Capital Gain	$ 21,210
Inclusion Rate	1/2
Taxable Capital Gain	$ 10,605

Exam Exercise Solution Fourteen - 20 (ITA 84(1) Deemed Dividend)

The transaction will result in an ITA 84(1) deemed dividend as follows:

PUC Of New Shares [($11.25)(10,000)]	$112,500
Increase In Net Assets	(100,000)
ITA 84(1) Deemed Dividend	$ 12,500

This will result in a deemed dividend per share of $0.208 ($12,500 ÷ 60,000). On Mr. Kai's 1,000 shares this will total $208.00.

Exam Exercise Solution Fourteen - 21 (ITA 84(2) Deemed Dividend)

The analysis of the $1,237,000 distribution would be as follows:

Cash Distributed	$1,237,000
PUC Of Shares	(189,000)
ITA 84(2) Deemed Dividend	$1,048,000
ITA 83(2) Capital Dividend	(146,000)
ITA 88(2)(b) Taxable Dividend	$ 902,000

To the extent the company has a balance in its GRIP account, some amount of the $902,000 dividend could be designated as eligible. Any remainder will be taxed as a non-eligible dividend (Not Required).

The wind-up results in a disposition of the shares. The tax consequences of this disposition are as follows:

Cash Distributed	$1,237,000
ITA 84(2) Deemed Dividend	(1,048,000)
ITA 54 Proceeds Of Disposition	$ 189,000
Adjusted Cost Base	(189,000)
Capital Gain	Nil

As shown by the preceding calculation, there would be no capital gain on the disposition.

Exam Exercise Solution Fourteen - 22 (ITA 84(2) Deemed Dividend)

The analysis of the $956,000 distribution would be as follows:

Cash Distributed	$956,000
PUC Of Shares	(120,000)
ITA 84(2) Deemed Dividend	$836,000
ITA 83(2) Capital Dividend	(45,000)
ITA 88(2)(b) Taxable Dividend	$791,000

To the extent the company has a balance in its GRIP account, some amount of the $791,000 dividend could be designated as eligible. Any remainder will be taxed as a non-eligible dividend (Not Required).

As the wind-up involves a disposition of shares, the tax consequences of this must also be considered:

Cash Distributed	$956,000
ITA 84(2) Deemed Dividend	(836,000)
ITA 54 Proceeds Of Disposition	$120,000
Adjusted Cost Base	(120,000)
Capital Gain	Nil

Exam Exercise Solution Fourteen - 23 (ITA 84(3) Deemed Dividend)

The redemption transaction would have no tax consequences for Mr. Izaak Alleham. For his sister, the tax consequences would be as follows:

Proceeds Of Redemption [(30,000)($24.35)]	$730,500
PUC [(30,000)($22.50)]	(675,000)
ITA 84(3) Deemed Dividend	$ 55,500
Gross Up Of 17 Percent	9,435
Taxable Dividend	$ 64,935

Proceeds Of Redemption [(30,000)($24.35)]	$730,500
ITA 84(3) Deemed Dividend	(55,500)
ITA 54 Proceeds of Disposition	$675,000
Adjusted Cost Base [(30,000)($18.75)]	(562,500)
Capital Gain (PUC - ACB)	$112,500
Inclusion Rate	1/2
Taxable Capital Gain	$ 56,250

Both the taxable dividend and the taxable capital gain would be included in Mr. Alleham's sister's Net Income For Tax Purposes. The non-eligible dividend qualifies for a federal dividend tax credit of $6,832 [(21/29)(17%)($55,500)].

Exam Exercise Solution Fourteen - 24 (ITA 84(3) Deemed Dividend)

The tax consequences to the dissident shareholder would be calculated as follows:

Proceeds Of Redemption [(15,000)($12.50)]	$187,500
PUC [(15,000)($12.00)]	(180,000)
ITA 84(3) Deemed Dividend	$ 7,500
Gross Up Of 17 Percent	1,275
Taxable Dividend	$ 8,775

Proceeds Of Redemption [(15,000)($12.50)]	$187,500
ITA 84(3) Deemed Dividend	(7,500)
ITA 54 Proceeds of Disposition	$180,000
Adjusted Cost Base [(15,000)($10.00)]	(150,000)
Capital Gain (PUC - ACB)	$ 30,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 15,000

Both the taxable dividend and the taxable capital gain would be included in the dissident shareholder's Net Income For Tax Purposes. The non-eligible dividend would qualify for a federal dividend tax credit of $923 [(21/29)(17%)($7,500)].

Exam Exercise Solution Fourteen - 25 (ITA 84(4) Deemed Dividend)

To the extent of the $217,000 PUC reduction, the dividend will be treated as a tax free distribution. The tax consequences will be a reduction in the PUC of these shares to $173,000 ($390,000 - $217,000), as well as an adjusted cost base reduction to $328,000 ($545,000 - $217,000).

The $82,000 ($299,000 - $217,000) excess of the distribution over the PUC reduction will be an ITA 84(4) deemed dividend, subject to either the eligible or non-eligible dividend gross up and tax credit procedures. As it will be taxed as a dividend, this part of the distribution will not be subtracted from the adjusted cost base of the shares.

Exam Exercise Solution Fourteen - 26 (ITA 84(4) Deemed Dividend)

An amount equal to the PUC reduction of $84,000 will be received as a tax free distribution. In addition to the PUC reduction for the shares to $141,000 ($225,000 - $84,000), the adjusted cost base for Martin's shares will be reduced by the same $84,000 to $226,000 ($310,000 - $84,000).

The remaining $28,000 ($112,000 - $84,000) will be treated as an ITA 84(4) deemed dividend. It will be subject to either the eligible or non-eligible gross up and tax credit procedures. Given that it will be taxed as a dividend, there will be no reduction in the adjusted cost base of Martin's shares for the $28,000.

TIF Solution Fourteen - 5A

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

A. 2

B. 11

C. 6

D. 9

E. 7

F. 1

G. 4

H. 8

The three unused definitions are as follows:

Group of Persons = 10

Deemed Dividends = 3

Shareholders' Equity = 5

TIF Solution Fourteen - 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. 2 (not 13)

B. 15

C. 9

D. 12 (not 6)

E. 10

F. 1 (not 5)

G. 7

H. 11 (not 4)

The three unused definitions are as follows:

Group of Persons = 14

Deemed Dividends = 3

Shareholders’ Equity = 8

TIF Solution Fourteen - 6

Part A - Non-Capital And Net Capital Losses - All Available Elections

The required write down on the equipment and the use of all available elections would have the following results:

	Business Income	Capital Gains
Required Equipment Write-Down		
Deemed CCA ($120,000 - $100,000)	($ 20,000)	
Election On Long-Term Investments		
[(1/2)($90,000 - $32,000)]		$29,000
Election On Land [(1/2)($225,000 - $140,000)]		42,500
Election On Building Recapture		
($426,000 - $320,000)	106,000	
Totals	$ 86,000	$71,500

With the use of these elections, Net Business Income for the period ending March 31, 2016 would be as follows:

Loss As Originally Stated	($ 26,000)
Deemed CCA On Equipment	(20,000)
Recapture On Building	106,000
Net Business Income - Period Ending March 31, 2016	$ 60,000

Based on the preceding analysis, Net and Taxable Income for the period ending March 31, 2016 would be calculated as follows:

ITA 3(a) Business Income		$ 60,000
ITA 3(b) Taxable Capital Gains		
Long-Term Investments	$ 29,000	
Land	42,500	71,500
ITA 3(c) And Net Income For Tax Purposes		$131,500
Net Capital Loss Carry Forward (Less Than $71,500)		(28,000)
Non-Capital Loss Carry Forward		
(Maximum Needed To Reduce Income To Nil)		(103,500)
Taxable Income		Nil

These results would leave a net capital loss carry forward of nil ($28,000 - $28,000) and a non-capital loss carry forward, calculated as follows:

December 31, 2015 Non-Capital Loss Carry Forward Balance	$225,000
Non-Capital Loss Carry Forward Deducted March 31, 2016	(103,500)
Non-Capital Loss Carry Forward	$121,500

Part B - Non-Capital And Net Capital Losses - Limited Elections

The only loss that will expire on March 31, 2016 is the $28,000 net capital loss carry forward. To be able to use this carry forward, a capital gain of $56,000 [(2)($28,000)] is required. This could be achieved by electing a deemed proceeds of disposition of $88,000 ($32,000 + $56,000) on the Long-Term Investments or, alternatively, electing a deemed proceeds of disposition of $196,000 ($140,000 + $56,000) on the Land. As the Long-Term Investments are about to be sold, this would be the better choice, as the increased adjusted cost base on this asset would serve to reduce the taxable capital gain that will result from their sale.

Part C - Advice On Course Of Action

If Foodland Inc. either does not intend to continue the same business in which the loss occurred, or does not expect to have sufficient profits in that business to absorb the non-capital losses within the relevant carry forward period, the Company should make all elections as per Part A. Alternatively, if they expect to have sufficient profits in continuing the bakery business to absorb the losses, they should use the Part B approach that maximizes the non-capital loss carry forward. The reason for this is that the tax benefit of the non-capital loss carry forward will be realized as soon as appropriate profits are available in the post-acquisition period. Alternatively, the higher asset costs that result from the Part A elections will only be realized if the assets are sold or, in the case of the building, as CCA is taken.

TIF Solution Fourteen - 7

Part A - Non-Capital And Net Capital Losses

Net Business Loss The net business loss for the period to April 30, 2016 would be as follows:

Loss As Per April 30, 2016 Income Statement	($46,000)
Required Accounts Receivable Adjustment ($90,000 - $76,000)	(14,000)
Building Election - Recaptured CCA ($325,000 - $300,000)	25,000
Equipment - Deemed CCA ($60,000 - $45,000)	(15,000)
Vehicles Election - Recaptured CCA ($132,000 - $110,000)	22,000
Net Business Loss For Period Ending April 30, 2016	($28,000)

Net And Taxable Income Net Income For Tax Purposes and Taxable Income for the period ending April 30, 2016, calculated as per the ITA 3 rules, would be as follows:

ITA 3(a) - Non-Capital Income (Positive Amounts Only)		Nil
ITA 3(b) - Net Taxable Capital Gains (Losses):		
Elections Under ITA 111(4)(e):		
Gain On Land [(1/2)($262,000 - $180,000)]	$ 41,000	
Gain On Building [(1/2)($380,000 - $325,000)]	27,500	
Required Write-Down - ITA 111(4)(c) And (d)		
Loss On Temporary Investments		
[(1/2)($45,000 - $12,000)]	(16,500)	$ 52,000
ITA 3(c) - Total		$ 52,000
ITA 3(d) - Net Business Loss		(28,000)
Net Income For Tax Purposes		$ 24,000
Net Capital Loss Carry Forward		
(Limited To Amount Included Under ITA 3(b))		(52,000)
Taxable Income		Nil

Lost Net Capital Loss The net capital loss balance that will be lost is calculated as follows:

Carry Forward From 2015	$96,000
Amount Deducted	(52,000)
Net Capital Loss Lost On Acquisition Of Control	$44,000

Non-Capital Loss Carry Forward The non-capital loss carry forward would be calculated as follows:

Business Loss For Period	$ 28,000
Net Capital Loss Deducted	52,000
Subtotal	$ 80,000
Income Under ITA 3(c)	(52,000)
Non-Capital Loss For The Period Ending April 30, 2016	$ 28,000
Non-Capital Loss Carry Forward From 2014	123,000
Non-Capital Loss Carry Forward From 2015	87,000
Non-Capital Loss Carry Forward At April 30, 2016	$238,000

Part B - Non-Capital Loss Carry Forward In 2016

The Net Income For Tax Purposes for the period ending December 31, 2016 will be $123,000 ($146,000 - $23,000). As none of this income was from the cleaning services business, none of the non-capital loss carry forward can be used in this period. This will leave the non-capital loss carry forward balance at December 31, 2016 unchanged at $238,000.

Part C - Loss Carry Forward In 2017

Net Income For Tax Purposes for 2017 will be $211,000 ($263,000 - $52,000). As all of this income is from the cleaning services business, this Net Income For Tax Purposes can be completely eliminated by a non-capital loss carry forward of $211,000, leaving a Taxable Income of nil. This will leave a non-capital loss carry forward from 2017 of $27,000 ($238,000 - $211,000).

TIF Solution Fourteen - 8

Case 1

As a group, Mr. Anson and Mr. Baron control both Anson Ltd. and Baron Inc. As a consequence, these two Companies would be associated under ITA 256(1)(b).

Case 2

Dunston Ltd. is associated with Edson Ltd. under ITA 256(1)(a) as it has control of this company. Dunston Ltd. is also associated with Farley Ltd. under ITA 256(1)(a) as it has indirect control by virtue of its control of Edson. Edson Ltd. and Farley Ltd. are also associated under ITA 256(1)(a) in that Edson Ltd. has direct control of Farley Ltd.

Case 3

The two Companies are not associated. While Larry Grange and George Lawrence are related, they are not a group with respect to the two Companies. For association to apply in a case such as this, there would have to be cross-ownership of at least 25 percent of the shares of one of the two companies. That is, either Larry Grange would have to own 25 percent or more of GL Inc., or George Lawrence would have to own 25 percent or more of LG Inc.

Case 4

Ms. Hanson controls Hanson Inc, is related to each member of the group (herself and her common-law partner) that controls Lilith Ltd., and has cross-ownership of Lilith Ltd. in excess of 25 percent. This means that these two Companies are associated under ITA 256(1)(d).

Ms. Hanson's common-law partner controls Porter Inc., is related to each member of a group that controls Lilith Ltd., and has the necessary cross-ownership of at least 25 percent of Lilith Ltd. shares. This means that these two Companies are also associated under ITA 256(1)(d).

As they are not controlled by the same individual or group, Hanson Inc. and Porter Inc. are not associated under ITA 256(1). However, as they are both associated with the same third corporation (Lilith Ltd.), Hanson Inc. and Porter Inc. would be associated under ITA 256(2). Note that ITA 256(2) allows Hanson Inc. and Porter Inc. to avoid association, provided Lilith Ltd. elects not to be associated with either Company. This will mean, however, that Lilith Ltd. will have a business limit for the period of nil.

Case 5

For the purposes of determining associated companies, Mr. Korngold controls BK ltd. which gives him control over that company's 30 percent interest in Lorey. In addition, he is deemed to own the 20 percent interest in Lorey Ltd. that is held by his minor child [ITA 256(1.3)]. This means his total interest is as follows:

Direct Interest	15 Percent
Indirect Interest Through Control Of BK Ltd.	30 Percent
Son's Shares	20 Percent
Total Interest	65 Percent

As this is a controlling interest, Mr. Korngold has control of both BK Ltd. and Lorey Ltd. Given this, the two companies are associated under ITA 256)(1)(b).

TIF Solution Fourteen - 9

Part A

Mr. Johnson and Mr. Langley are a group that controls Astro Inc. However, they do not control Borealis Ltd., as Mr. Kohn (not a member of the group that controls Astro Inc.) owns 50 percent of the shares. Therefore, Astro Inc. and Borealis Ltd. are not associated.

Part B

While they are not related, Ms. Martineau and Ms. Olson constitute a group [ITA 256(1.2)(a)] with respect to both Kisler Inc. and Pardo Ltd. As both Kisler Inc. and Pardo Ltd. are controlled by the same group, the two Companies are associated under ITA 256(1)(b).

Part C

The Lane sisters are clearly related. In addition, under ITA 256(1.5) a person who owns shares in two or more corporations shall be, as a shareholder of one of the corporations, deemed to be related to himself as a shareholder of the other corporation(s).

Given this, FL Inc. and Lane Ltd. are associated under ITA 256(1)(d). Fiona Lane controls FL Inc., is a member of a related group (Fiona and Jennifer Lane) that controls Lane Ltd., and owns more than 25 percent of the shares of Lane Ltd.

In similar fashion, JL Inc. is associated with Lane Ltd. under ITA 256(1)(d). Jennifer Lane controls JL Inc., is a member of a related group (Fiona and Jennifer Lane) that controls Lane Ltd., and owns more than 25 percent of the shares of Lane Ltd.

Based on these associations, FL Inc. and JL Inc. are associated under ITA 256(2), as they are both associated with a third corporation, Lane Ltd.

Part D

For purposes of determining associated companies, Ms. Garland is deemed to own the 10 percent interest in Newton Ltd. that is held by her minor child [ITA 256(1.3)], as well as the 40 percent interest for which she holds options [ITA 256(1.4)]. When these interests are combined with her 10 percent direct interest in Newton Ltd., she would be considered to be in control of Newton Ltd. As she controls both Garland Inc. and Newton Ltd., these two Companies would be associated under ITA 256(1)(b).

Part E

With his 70 percent interest, Mr. Barnes controls Noble. This, in turn, gives him control over Noble's 40 percent interest in Borders. When combined with his direct interest of 24 percent, his total interest of 64 percent gives him control over Borders.

As both companies are controlled by the same person, the two Companies are associated under ITA 256(1)(b).

TIF Solution Fourteen - 10

Case A

With respect to the $230,000 in apprentice salaries, the investment tax credit is available on an annual salary maximum of $20,000 per apprentice. As a result, there will be a $20,500 [(7)(10%)($15,000) + (5)(10%)($20,000 maximum)] credit against 2015 federal Tax Payable. This $20,500 credit will be added to income in 2016.

With respect to the $1,500,000 in capital expenditures, there will be a 2016 credit against federal Tax Payable of $150,000 [(10%)($1,500,000)].

The $150,000 credit will not influence the calculation of 2015 CCA. This amount will be $375,000 [(50%)(1/2)($1,500,000)].

In 2016, the $150,000 credit will be deducted from the January 1, 2016 UCC, leaving a balance of $975,000 ($1,500,000 - $375,000 - $150,000). Given this, 2016 CCA will be $487,500 [(50%)($975,000)].

Case B

Luxor's annual expenditure limit would be $1,394,900. This amount is calculated as follows:

[$8 million – (10)($652,000*)][($40 million – $2,300,000) ÷ $40 million]

*Greater of $500,000 and the corporation's Taxable Income for the preceding year

Case C

Martin's annual expenditure limit would be $2,917,500, calculated as follows:

[$8 million – (10)($500,000*)][($40 million – $1,100,000) ÷ $40 million]

*Greater of $500,000 and the corporation's Taxable Income for the preceding year

The amount of SR&ED Expenditure that would be eligible for the 35 percent rate can be calculated as follows:

Total Current SR&ED Expenditures	$3,300,000
Annual Expenditure Limit	(2,917,500)
Limited To 15 Percent Rate	$ 382,500

The total amount of investment tax credits available can be calculated as follows:

Qualified Property [(10%)($110,000)]	$ 11,000
SR&ED Current Expenditures:	
At 35 Percent Rate [(35%)($2,917,500)]	1,021,125
At 15 Percent Rate [(15%)($382,500)]	57,375
Total Available Amount	$1,089,500

Martin is a qualifying corporation. The refund available would be as follows:

	Rate	ITC	Refund
Qualified Property	40%	$ 11,000	$ 4,400
SR&ED Current Expenditures	100%	1,021,125	1,021,125
SR&ED Current Expenditures	40%	57,375	22,950
Total Available		$1,089,500	$1,048,475

The non-refunded investment tax credit of $41,025 ($1,089,500 - $1,048,475) can be carried forward 20 years to be applied against Tax Payable. There was no Tax Payable in the last three years so it cannot be carried back.

The cost of the qualified property will be reduced in the following year by the refundable investment tax credit of $4,400. The $1,044,075 ($1,021,125 + $22,950) refundable tax credit on current SR&ED expenditures will be added to income in the following taxation year.

TIF Solution Fourteen - 11

The December 31, 2016 balance in the capital dividend account is calculated as follows:

2006 Capital Gain [(1/2)($114,200 - $73,600)]	$ 20,300
2009 Capital Dividend Received	42,100
2011 Capital Dividend Paid	(23,100)
2012 Capital Gain [(1/2)($176,200 - $123,400)]	26,400
2012 Capital Loss [(1/2)($198,600 - $220,400)]	(10,900)
2013 Life Insurance Proceeds	131,600
2016 Franchise Sale (See Calculation Below)	30,000
2016 Capital Dividend Paid	(45,200)
Balance December 31, 2016	$171,200

The income inclusion resulting from the sale of the franchise can be calculated as follows:

	CEC Balance	CEC Deduction
2014 CEC Addition [(3/4)($315,000)]	$236,250	
2014 Amortization [(7%)($236,250)]	(16,538)	$16,538
Balance January 1, 2015	$219,712	
2016 Amortization [(7%)($219,712)]	(15,380)	15,380
Balance January 1, 2016	$204,332	
Proceeds Deducted [(3/4)($375,000)]	(281,250)	
Balance After Sale	($ 76,918)	$31,918

The negative balance in the CEC account after the sale is more than the total of the CEC deductions in the past two years ($31,918). Given this, the income inclusion will be as follows:

- $31,918 (the CEC deducted), plus
- $30,000 [(2/3)($76,918 - $31,918)].

As a result, $61,918 ($31,918 + $30,000) will be included in income in 2016.

Note that the $30,000 income inclusion could also be calculated by taking one-half of the gain (similar to capital gains treatment) on the disposition [$30,000 = (1/2)($375,000 - $315,000)]. This is also the amount that is added to the capital dividend account as a result of the franchise sale.

TIF Solution Fourteen - 12

Case 1

The tax consequences to Milly Brant resulting from the redemption of her shares would be as follows:

Proceeds Of Redemption	$3,200,000
PUC [(125,000)($23)]	(2,875,000)
ITA 84(3) Deemed Dividend	$ 325,000

Proceeds Of Redemption	$3,200,000
ITA 84(3) Deemed Dividend	(325,000)
ITA 54 Proceeds Of Disposition	$2,875,000
Adjusted Cost Base [($18.60)(125,000)]	(2,325,000)
Capital Gain	$ 550,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 275,000

The deemed dividend will be grossed up to $380,250 [(117%)($325,000)]. This will result in a total increase in Taxable income of $655,250 ($380,250 + $275,000). The dividend will generate a federal dividend tax credit of $40,009 [(21/29)(17%)($325,000)].

With respect to the shares still held by Milly Brant, they would have PUC of $8,625,000 [($23)(500,000 - 125,000)]. Their adjusted cost base would be $6,975,000 [($18.60)(500,000 - 125,000)].

Case 2

The analysis of the distribution would be as follows:

Cash Distributed	$2,750,000
PUC Of Shares	(75,000)
ITA 84(2) Deemed Dividend	$2,675,000
ITA 83(2) Capital Dividend	(243,000)
ITA 88(2)(b) Wind-Up Dividend	$2,432,000

Cash Distributed	$2,750,000
ITA 84(2) Deemed Dividend	(2,675,000)
ITA 54 Proceeds Of Disposition	$ 75,000
Adjusted Cost Base	(463,000)
Capital Loss	($ 388,000)
Inclusion Rate	1/2
Allowable Capital Loss	($ 194,000)

The capital dividend would be distributed tax free. The $2,432,000 wind-up dividend would be grossed up to $2,845,440 [(117%)($2,432,000)]. It will also provide for a federal dividend tax credit of $299,388 [(21/29)(17%)($2,432,000)]

The allowable capital loss can be used in the current year, only to the extent of taxable capital gains realized in the current year.

Case 3

To the extent of the $78,000 PUC reduction, the liquidating dividend will be treated as a tax free distribution to Ms. Stew. However, there will be tax consequences related to this distribution:

- The PUC of Ms. Stew's shares will be reduced to $349,000 ($427,000 - $78,000).
- The ACB of Ms. Stew's shares will be reduced to $484,000 ($562,000 - $78,000).

The $74,000 ($152,000 - $78,000) excess of the distribution over the PUC reduction will be an ITA 84(4) deemed dividend. For purposes of determining Taxable Income, this amount will be grossed up to $86,580 [(117%)($74,000)]. It will generate a federal dividend tax credit of $9,110 [(21/29)(17%)($74,000)]. The deemed dividend part of the distribution will not be subtracted from the adjusted cost base of the shares.

Case 4

This transaction will result in an ITA 84(1) deemed dividend for all shareholders, calculated as follows:

PUC Of New Shares [(21,000)($35)]	$735,000
Increase In Net Assets (Liability Eliminated)	(700,000)
ITA 84(1) Deemed Dividend	$ 35,000

This would be allocated to all 200,000 (179,000 + 21,000) shares outstanding, on the basis of $0.175 per share ($35,000 ÷ 200,000). Robbie's share of the deemed dividend is $4,699 [(26,850)($0.175)]. For inclusion in Taxable Income, this amount will be grossed up to $5,498 [($4,699)(117%)].

When the $0.175 per share deemed dividend is added to the adjusted cost base of Robbie's shares, this value will be equal to $30.175 per share ($30.00 + $0.175).

The tax consequences of Robbie selling his shares would be as follows:

Proceeds Of Disposition [(26,850)($37.00)]	$993,450
Adjusted Cost Base [(26,850)($30.175)]	(810,199)
Capital Gain	$183,251
Inclusion Rate	1/2
Taxable Capital Gain	$ 91,626

This will result in a total increase in Taxable Income of $97,124 ($91,626 + $5,498).

Also for Robbie, there will be a federal dividend tax credit of $578 [(21/29)(17%)($4,699)].

TIF Solution Fourteen - 13

Case 1

To the extent of the $162,000 PUC reduction, the liquidating dividend will be treated as a tax free distribution to Marion. However, there will be tax consequences related to this distribution:

- The PUC of Marion's shares will be reduced to $521,000 ($683,000 - $162,000).
- The ACB of Marion's shares will be reduced to $561,000 ($723,000 - $162,000).

The $61,000 ($223,000 - $162,000) excess of the distribution over the PUC reduction will be an ITA 84(4) deemed dividend. The deemed dividend part of the distribution will not be subtracted from the adjusted cost base of the shares.

- Increase In Taxable Income = Grossed Up Dividend [(117%)($61,000)] $71,370
- Federal Dividend Tax Credit [(21/29)(17%)($61,000)] $ 7,509

Case 2

This transaction will result in an ITA 84(1) deemed dividend for all shareholders, calculated as follows:

PUC Of New Shares [(30,000)($20)]	$600,000
Increase In Net Assets (Liability Eliminated)	(550,000)
ITA 84(1) Deemed Dividend	$ 50,000

This would be allocated to all 255,000 (225,000 + 30,000) shares outstanding, on the basis of $0.196 per share ($50,000 ÷ 255,000). This amount will also be added to the adjusted cost base of the shares.

Given that Jason acquired his 33,750 [(15%)(225,000)] shares for $15 per share, the tax consequences of Jason owning and selling his shares would be as follows:

Grossed Up Dividend [(33,750)(117%)($0.196)]	$ 7,740
Proceeds Of Disposition [(33,750)($23.00)]	$776,250
Adjusted Cost Base [(33,750)($15.00 + $0.196)]	(512,865)
Capital Gain	$263,385
Inclusion Rate	1/2
Taxable Capital Gain (All Shares Sold)	$131,693

- Increase In Taxable Income ($7,740 + $131,693) $139,433
- Federal Dividend Tax Credit [(33,750)(21/29)(17%)($0.196)] $814

Case 3

The analysis of the distribution would be as follows:

Cash Distributed	$1,875,000
PUC Of Shares	(125,000)
ITA 84(2) Deemed Dividend	$1,750,000
ITA 83(2) Capital Dividend	(321,000)
ITA 88(2)(b) Wind-Up Dividend	$1,429,000

Cash Distributed	$1,875,000
ITA 84(2) Deemed Dividend	(1,750,000)
ITA 54 Proceeds Of Disposition	$ 125,000
Adjusted Cost Base	(364,000)
Capital Loss	($ 239,000)
Inclusion Rate	1/2
Allowable Capital Loss	($ 119,500)

The capital dividend would be distributed tax free.

The allowable capital loss can be used in the current year, only to the extent of taxable capital gains realized in the current year.

- Increase In Taxable Income = Grossed Up Dividend [(117%)($1,429,000)] $1,671,930
- Federal Dividend Tax Credit [(21/29)(17%)($1,429,000)] $175,915

Case 4

The tax consequences to Lawrence Foster resulting from the redemption of his shares would be as follows:

Proceeds Of Redemption	$1,700,000
PUC [(50,000)($32)]	(1,600,000)
ITA 84(3) Deemed Dividend	$ 100,000

Proceeds Of Redemption	$1,700,000
ITA 84(3) Deemed Dividend	(100,000)
ITA 54 Proceeds Of Disposition	$1,600,000
Adjusted Cost Base [(50,000/300,000)($8,400,000)]	(1,400,000)
Capital Gain	$ 200,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 100,000

- Increase In Taxable Income [(117%)($100,000) + $100,000] $217,000
- Federal Dividend Tax Credit [(21/29)(17%)($100,000)] $12,310
- No effect on ACB or PUC of remaining shares.

With respect to the shares still held, they would have a PUC of $8,000,000 [($32)(300,000 - 50,000)]. Their adjusted cost base would be $7,000,000 [($28)(300,000 - 50,000)].

Chapter Fifteen Test Item File Solutions

TIF Solution Fifteen - 1

1. The use of a corporation only provides significant tax deferral in those cases where income can be left in the business and not paid out to the shareholders. As Frank requires all of the income of his business in order to provide for his personal consumption needs, the use of a corporation will not provide any deferral. However, as he anticipates that the business's income will exceed his personal consumption needs in the foreseeable future, there will be deferral on amounts of income that are left in the corporation in future years.

   It appears that Frank's business would be a CCPC earning active business income. Provided this income does not exceed the amount eligible for the small business deduction, in most provinces there will be a tax savings resulting from the use of a corporation. However, this tax savings may not be large enough to justify the costs of establishing and maintaining a corporation.

2. As described in the text, the two basic types of benefits are as follows:

   Tax Reduction In some situations, the total taxes that would be paid at the combined corporate and personal level will be less when the business is incorporated than would be the case if the individual had earned the business income directly as an individual proprietor.

   Tax Deferral Getting income from its source through a corporation and into the hands of a shareholder involves two levels of taxation. If the shareholder does not require all available income for his personal needs, after tax funds can be left in the corporation, resulting in a postponement of the second level of taxation. If the rate at which the corporation is taxed is lower than the rate at which the individual would be taxed on the direct receipt of the income, the use of a corporation provides tax deferral.

3. Because a corporation is a separate legal entity, the shareholders' liabilities to creditors are limited to the amount that they have invested. That is, creditors of the corporation can look only to the assets of the corporation for satisfaction of their claims. However, for owner-managed corporations, obtaining significant amounts of financing will almost always require the owners to provide personal guarantees on any loans, making this advantage somewhat illusory for this type of company. Note, however, limited liability may still be important for a business that is exposed to significant product or environmental claims.

4. The goal of integration is to ensure that, when a corporation is used, the combined corporate and individual taxes paid will be same as those paid by an individual receiving the same income directly. For eligible dividends, the enhanced gross up and tax credit procedures are based on the assumption of a combined federal/provincial corporate tax rate of 27.54 percent. For non-eligible dividends, the gross up and tax credit procedures are based on the assumption of a combined federal/provincial corporate tax rate of 14.53 percent. If the actual combined rate exceeds these rates, it will discourage the use of a corporation. If the actual combined rate is less than these rates, use of a corporation becomes more attractive.

   The other assumption that is inherent in the integration system is that the combined federal/provincial dividend tax credit will be equal to the gross up. For eligible dividends, the federal credit is equal to 6/11 of the gross up. For the combined credit to equal the gross up, the provincial credit must be equal to 5/11 of the gross up. For non-eligible dividends, the federal credit is equal to 21/29 of the gross up. For the combined credit here to equal the gross up, the provincial credit must be equal to 8/29 of the gross up. If the provincial credit exceeds these values, the combined credit exceeds the notional corporate taxes and makes the use of a corporation more attractive. Alternatively, if the provincial credit is less than these values, the credit does not compensate for corporate taxes paid and this discourages the use of a corporation.

5. For income splitting to be an effective tax planning strategy, there must be significant differences in the income levels of individuals in a related group. Income splitting is based on the idea that some amount of income will be transferred from individuals in a high tax bracket to individuals in a low tax bracket. This will create a savings based on the difference between the tax rates applicable to the two individuals. A typical situation would be a parent in the 29 or 33 percent federal tax bracket, with adult children with little or no income.

6. Until the business becomes profitable, it would be best to continue operations as a proprietorship. The major reason for this advice is that, if he continues to operate as a proprietorship, he can deduct his losses against his other sources of income (e.g., investment income). In contrast, if he incorporates the business, he will have to carry the losses forward until such time as the business becomes profitable and cannot use the loss personally. In addition, if he plans on the business making charitable contributions, if he does not incorporate, he will be able to claim a personal tax credit for the contributions. In contrast, if he incorporates, such contributions will have to be carried forward to be deducted when the business becomes profitable.

7. The effect of a provincial tax holiday for a Canadian controlled private corporation is to reduce the overall tax rate on the first $500,000 of active business income to 10.5 percent (38% - 10% - 17.5% + 0%). This is 4.03 percent below the 14.53 percent rate that is assumed in the integration provisions and, as a consequence, the tax deduction associated with salary payments would be less significant. Without considering other factors, the presence of a provincial tax holiday would favour the use of dividend payments to the owner-manager over the use of salary compensation.

8. For integration to work for a large public company, the combined federal/provincial tax rate on corporations must be 27.54 percent. In addition, the provincial dividend tax credit for eligible dividends must be equal to 5/11 of the dividend gross up.

9. Bonusing down is a tax planning technique that involves paying deductible salary amounts to an owner-manager in order to reduce a CCPC's active business income to the amount that is eligible for the small business deduction. The advantage of bonusing down is that the personal taxes paid on the salary will sometimes be less than the corporate tax on income in excess of the small business deduction, combined with the taxes paid by the owner-manager when the after tax income is distributed to him as dividends.

10. If Ms. Copeland receives the dividends directly, the effective tax rate will be 26.4 percent {[(Dividends)(138%)(29% + 12%)] - [(Dividends)(38%)(6/11 + 25%)]}. Given that her investments are in large public companies, if she incorporates, the dividends would be subject to Part IV tax at a rate of 38-1/3 percent. This means that there is no tax deferral through the use of a corporation in this situation.

    With respect to tax savings, the 38-1/3 percent Part IV tax would be refunded and the full amount of dividends received by the corporation could be paid out to Ms. Copeland. The tax that she would pay would be exactly the same as if she had received the dividends directly. This means that there would be no tax savings through the use of a corporation in this situation.

11. When a corporation is used, there are two levels of taxation. Taxes are assessed at the corporate level and again at the personal level. If the individual does not require all of the income for his personal needs and can leave some part of the income in the corporation, the second level of taxation can be delayed. However, whether or not this will be beneficial depends on the combined federal/provincial tax rate on the corporation. If this combined rate is less than the rate applicable to the individual on the direct receipt of income, the deferral will be beneficial. If the combined rate is higher, the deferral will not be beneficial.

12. With respect to combined federal/provincial corporate tax rates, rates that are higher than 27.54 percent make the use of a corporation less desirable, while rates that are less than 27.54 percent make incorporation more desirable.

    With respect to the combined federal/provincial dividend tax credit, a credit that is larger than the dividend gross up will make incorporation more desirable, while a credit that is smaller than the dividend gross up will make the use of a corporation less desirable.

13. For each dollar of non-eligible dividends received, the individual must add a gross up of $0.17 to Taxable Income. For individuals in the lowest federal tax bracket, the federal tax on this amount will be $0.1755 [($1.17)(15%)]. However, there will be a federal credit against this tax payable equal to 21/29 of the gross up, or $0.1231 [(21/29)($0.17)]. This means that, as long as an individual is in the lowest federal tax bracket, the increase in tax associated with one dollar of non-eligible dividends received can be calculated as follows:

Federal Tax Payable On Grossed Up Dividend	$.1755
Federal Dividend Tax Credit	(.1231)
Increase In Federal Tax Payable	$.0524

    As compared to an increase in federal tax of $0.15 for each one dollar increase in interest income, there is only a $0.0524 increase in federal tax for each one dollar increase in dividends received. This means that dividend income uses up an individual's available tax credits at a much slower rate than other types of income. For example, while one dollar of interest income will use up one dollar [($1.00)($.15 ÷ $.15)] of an individual's personal tax credit base of $11,474, one dollar of non-eligible dividends received will use up only $0.3493 of this base [($1.00)($.0524 ÷ $.15)]. This means that, in comparison with other types of income, a much larger amount of dividends can be received before an individual's tax credits are absorbed and taxes will have to be paid.

14. Ms. Simsung could establish a new corporation and transfer all or part of her investments to that entity. In return, she would receive a combination of debt which pays interest at the prescribed rate (currently 1 percent), along with preferred shares which would have the votes that control the corporation. Her children could then purchase non-voting shares with the right to receive the income from the investments. Depending on the amount of such income, the income could be received on a tax free basis. Alternatively, if Ms. Simsung continues to hold the investments, this income would be taxed at maximum rates.

15. Unlike the situation with publicly traded companies, the owner-manager is subject to few constraints on the use of the corporate assets. In effect, he is in a position to provide significant benefits to himself and other related individuals without review by internal and external auditors or concern about the financial effects on unrelated shareholders. This allows the owner-manager much more flexibility in designing a compensation package.

16. This would not be a good idea. To begin, the value of the pool would be included in your friend's income on the same basis as the payment of an equivalent amount of salary. However, as the pool would be a benefit under ITA 15(1), its cost would not be deductible to his company. The friend would be better off either paying sufficient salary to finance the pool (while he would pay taxes on the salary, the amount paid would be deductible to the company) or, alternatively, paying sufficient dividends to finance the pool (while the dividends could not be deducted by the corporation, they would be taxed more favourably than the taxable benefit resulting from the construction of the pool).

17. The two required exceptions can be selected from the following:

    - The general rule does not apply when the loan is in the ordinary course of the corporation's business.
    - The general rule does not apply when the loan is repaid within one year after the end of the taxation year of the lender or creditor in which the loan was made or the indebtedness arose.
    - The general rule does not apply to indebtedness between non-resident persons. This means that, if both the corporation and the shareholder receiving the loan were non-residents, the principal amount of any loan would not have to be included in income.

18. In order to make a convincing case that the loan was received by the owner-manager in his capacity as an employee, the same type of loan must be extended to all employees with similar duties and responsibilities. If the loan is particularly large, or on particularly favourable terms, the owner-manager may not wish to extend this privilege. In addition, in some cases the business may not have other senior employees or any other employees at all. This could make it impossible to make the case for receipt of the loan as an employee. The CRA, in cases where a private corporation has few employees with which to make a comparison, looks to what is standard or accepted practice within a given industry in deciding whether a loan is received in an employment capacity.

19. There are three advantages to having an employee benefit, rather than a shareholder benefit:

    - The principal amount does not have to be included in John's income when the loan is made.
    - If the loan is an employee loan, for the first five years of the loan, the benefit calculation rate will go no higher than the prescribed rate that prevailed when the loan was made.
    - If the loan is an employee loan, John will be eligible for the home relocation loan deduction.

20. The required two examples can be selected from the following items listed in the text:

    - **Registered Pension Plans** Within prescribed limits, a corporation can deduct contributions to Registered Pension Plans in the year of contribution. These contributions will not become taxable to the employee until they are received as a pension benefit, resulting in an effective tax deferral arrangement.
    - **Deferred Profit Sharing Plans** In a fashion similar to Registered Pension Plans, amounts that are currently deductible to the corporation are deferred with respect to inclusion in the employee's Taxable Income.
    - **Provision Of Private Health Care Plans** The premiums paid by the corporation for such benefits as dental plans can be deducted in full by the corporation and will not be considered a taxable benefit to the employee. This can generate a significant tax savings.
    - **Stock Options** Stock options provide employees with an incentive to improve the performance of the enterprise. In addition, taxation of any benefits resulting from the options is deferred until they are exercised or sold (for a full discussion of the deferral of stock option benefits, see Chapter 3). Further, the value of the employment benefit received is enhanced by the fact that, in general, one-half of the amount can be deducted in the calculation of Taxable Income.

    Other examples may be acceptable.

21. The required three factors could be chosen from the following:

    - Corporate Tax Payable - Salary's deductibility is not currently important if there is no Tax Payable.
    - The added costs of CPP, EI, and payroll taxes discourage the use of salary.
    - Dividends do not provide an addition to Earned Income for RRSP purposes.
    - Dividends do not provide an addition to Earned Income for deductible child care purposes.
    - Dividends reduce a CNIL balance.
    - Salary can provide CPP and Canada Employment tax credits to the owner-manager.

22. As dividends use up available tax credits at a much slower rate than is the case with salary, the payment of all compensation in the form of dividends may result in unused tax credits for the current taxation year. As most of these credits are non-refundable, if they are not used during the current year they will be lost. Given this, it may be beneficial to pay a combination of salary and dividends that is sufficient to use up all of the individual's non-refundable tax credits.

TIF Solution Fifteen - 2

New For 2016

1. False. Corporate losses cannot be used against an individual's other sources of income.

2. True.

3. False. The higher credit makes using a corporation more attractive.

4. False. It is a procedure that is used to avoid having amounts of active business income in excess of amounts eligible for the small business deduction taxed at high corporate rates.

5. True.

6. False. If he has the corporation build the pool, he will have a taxable benefit equal to the cost of the pool. While his taxes on this amount are likely to be similar to those that would be paid on an equivalent amount of salary, the difference is that the corporation can deduct the cost of the salary. In contrast, the corporation will not be able to deduct the shareholder benefit.

7. False. Shareholder loans do not have to be included in Net Income For Tax Purposes if the corporation makes loans in the ordinary course of their business as the Royal Bank does.

8. True.

9. True.

10. False. Salary increases the Earned Income base for making RRSP contributions. Dividends do not increase this base.

Retained From Previous Editions

11. False. Higher corporate rates favour the direct receipt of income.

12. True. As charitable donations are a deduction for a corporation, they would have a value of $0.12 on the dollar to a corporation that is taxed at 12 percent. In contrast, donations made by individuals create a federal credit against Tax Payable of $0.15, $0.29 or $0.33 on the dollar, all of which are higher than the combined rate of $0.12. There would be additional credits at the provincial level for individuals.

13. False. Income splitting refers to procedures designed to divide an individual's income between a group of related individuals.

14. False. A low provincial dividend tax credit favours the use of salary.

15. True.

16. False. Only individuals with no other source of income can receive this amount of dividends tax free.

TIF Solution Fifteen - 3

New For 2016/2017

1. B. The use of a corporation will always result in deferral of taxes on income that is left in the corporation. For some types of corporate income, the corporate tax rate may be higher than the rate applicable to the individual.

2. A. Joan's financial risk is limited to $1,150,000.

3. C. Differing federal dividend tax rates for eligible and non-eligible dividends.

4. D. For individuals in the lowest tax bracket, dividends always use up tax credits at a slower rate than other types of income.

5. B. Income splitting can only be accomplished by using a corporation.

6. A. A loan to an owner-manager to allow him to purchase a personal residence. The loan does not have a specific repayment date.

7. D. Salary payments.

Retained From Previous Editions

8. B. The ability to absorb business losses against employment income.

9. B. The taxpayer has significant personal assets and investment income, and does not need all of the cash from her business in order to pay day to day living expenses.

10. D. The corporation is a CCPC earning active business income.

11. D. Dividend payments may be deferred until after a shareholder has retired; a capital gains deduction may be available if conditions are met; and active business income under $500,000 is eligible for a lower tax rate.

12. A. Incorporating a CCPC earning only Active Business Income eligible for the small business deduction.

13. C. Because if the income over $500,000 remains in the company it will not benefit from the small business deduction, and therefore the after tax retention on this excess income in the company will be lower than it would be on paying a salary to Ms. Rothstein.

14. B John could protect himself from being held personally liable if a client sustained injuries by falling overboard.

15. C. All of the federal corporate taxes paid on the dividends would be refunded when all of the dividends received by the corporation are paid out to the individual.

16. C. Incorporation will result in a deferral of taxes to the extent profits can be left in the corporation.

17. A. There can be a small tax advantage associated with incorporation. C is incorrect as the individual needs all of the earnings so there is no deferral.

18. C. There will be tax deferral because of the small business deduction.

19. B. The combined federal/provincial tax rate on corporations is less than the combined federal/provincial tax rate on individuals.

20. C. The combined federal/provincial tax rate on individuals.

21. i. C. The amount of the loan of $30,000 must be added to the shareholder's income as the loan is going to be outstanding on two consecutive corporate year ends. No imputed interest will be added to income.

ii. F. The imputed interest of $450 [(9/12)(2%)($30,000)] will be added to income. However, as the proceeds of the loan were used to make an income producing investment, the imputed interest will be deductible under ITA 20(1)(c) through ITA 80.5. The net effect on Taxable Income is nil.

iii. C. The amount of the loan of $30,000 must be added to the shareholder's income as the loan is going to be outstanding on two consecutive corporate year ends. No imputed interest will be added to income. Since the shareholder is not an employee, there is no exception for a housing loan.

22. A. $5,000 in 2016. ITA 15(2) taxes the amount of the loan to the recipient of the loan. In this case, Albert Jay is taxed on $5,000 in 2016 and his son would be taxed on $2,000 for 2016, as the loans were still outstanding on January 31, 2018.

23. C. Jacquie's 2016 Taxable Income is:

Grossed Up Non-Eligible Dividend [($1,100)(117%)]		$1,287.00
ITA 80.4 Interest Benefit		
[($10,000)(4%)(90/365)]	$98.63	
[($10,000)(3%)(91/365)]	74.79	173.42
ITA 20(1)(c) Interest Deduction		
[($10,000 - $2,000)(4%)(90/365)]	($78.90)	
[($10,000 - $2,000)(3%)(91/365)]	(59.84)	(138.74)
Total		$1,321.68

24. C. It must be repaid within one year of the end of the fiscal year in which it was made.

25. A. Martin will have to include $350,000 in his 2015 Net Income For Tax Purposes.

26. D. The corporation purchases life insurance on the life of the shareholder in order to ensure that the company has the necessary funds to deal with a sudden unexpected death of the shareholder.

27. C. A desire to eliminate a large CNIL balance.

28. C. The corporation has Taxable Income in excess of $500,000.

29. B. He should take the salary because he will have more left after tax. Since the Company is not a CCPC, it is not eligible for the small business deduction. The fact that the company will pay dividends that are eligible for the enhanced gross up and tax credit procedures will not compensate Larry for corporate taxes paid at a 32 percent rate (the rate assumed for the enhanced credit is 27.54 percent).

30. D. The best solution is to take the funds out as salary so that she can maximize her contribution to her RRSP.

TIF Solution Fifteen - 4

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

Mr. Lee's combined tax rate on income earned by the unincorporated business is 49 percent (33% + 16%). If he does incorporate, all of the $98,000 will be eligible for the small business deduction. This means that it will be taxed at a rate of 15 percent (38% - 10% - 17.5% + 4.5%).

Mr. Lee's tax rate on non-eligible dividend income is 40.3 percent [(117%)(49%) - (21/29 + 8/29)(17%)]. Using these tax rates, the relevant calculations are as follows:

	With Corporation	Without Corporation
Business Income	$98,000	$98,000
Tax Rate	15%	49%
Tax Payable	$14,700	$48,020
Business Income	$98,000	$98,000
Tax Payable	(14,700)	(48,020)
Maximum Non-Eligible Dividend Payable	$83,300	N/A
Personal Tax On Dividends [(40.3%)($83,300)]	(33,570)	N/A
Income Retained By Mr. Lee	$49,730	$49,980

There is clearly a significant amount of tax deferral with respect to income left in the corporation. His Tax Payable on direct receipt of the $98,000 of business income would be $48,020, far higher than the $14,700 that would be paid by the corporation.

After tax retention with the use of a corporation would be $49,730. This is $250 less than the $49,980 that would be retained through direct receipt of this income. You should advise your client that using a corporation would result in an overall tax cost, making it not advisable to incorporate this business.

Exam Exercise Solution Fifteen - 2
(Use Of A Corporation For Tax Deferral And Savings)

Ms. Ho's tax rate on income earned by her unincorporated business is given as 51 percent. If she chooses to incorporate, all of the income earned by the corporation will be eligible for the small business deduction and will be taxed at a rate of 14 percent (38% - 10% - 17.5% + 3.5%). Ms. Ho's tax rate on non-eligible dividend income is 44 percent [(117%)(51%) - (21/29 + 20%)(17%)].

Using these tax rates, the relevant calculations are as follows:

	With Corporation	Without Corporation
Business Income	$142,000	$142,000
Tax Rate	14%	51%
Tax Payable	$ 19,880	$ 72,420
Business Income	$142,000	$142,000
Tax Payable	(19,880)	(72,420)
Maximum Non-Eligible Dividend Payable	$122,120	N/A
Personal Tax On Dividends [(44%)($122,120)]	(53,733)	N/A
Income Retained By Ms. Ho	$ 68,387	$ 69,580

If Ms. Ho's business continues to be unincorporated, taxes will be $72,420, more than three times the amount of tax that would be paid at the corporate level if she decides to incorporate. There is clearly significant tax deferral on income that is not removed from the corporation.

However, there is a tax cost if the income is removed from the corporation. The cost is $1,193, $69,580 without the corporation, compared to $68,387 with the corporation.

Exam Exercise Solution Fifteen - 3 (Incorporation Of Interest Income)

Ms. MacDonald's combined tax rate on interest income earned outside the corporation is 51 percent (33% + 18%). If she incorporates, the interest income will not be eligible for the small business deduction or the general rate reduction and it will be subject to the ART. This means that, if the investments are transferred to a corporation, the interest will be taxed at a rate of 52-2/3 percent (38% - 10% + 10-2/3% + 14%).

Ms. MacDonald's tax rate on non-eligible dividends received is 43.1 percent [(117%)(51%) - (21/29 + 25%)(17%)].

Using these tax rates, a comparison of the income retained with and without the use of a corporation is as follows:

	With Corporation	Without Corporation
Interest Income	$143,000	$143,000
Tax Rate	52-2/3%	51%
Tax Payable	$ 75,313	$ 72,930
Interest Income	$143,000	$143,000
Tax Payable	(75,313)	(72,930)
Net Corporate Income Before Dividend Refund	$ 67,687	N/A
Maximum Dividend Refund (See Note)	42,075	
Maximum Dividend Payable	$109,762	
Personal Tax On Dividends [(43.1%)($109,762)]	(47,307)	
Income Retained By Ms. MacDonald	$ 62,455	$ 70,070

RDTOH Balance [(30-2/3%)($143,000)]	$43,853

Note The refund is the lesser of 38-1/3 percent of dividends paid and the balance in the RDTOH account. The after tax funds would support a dividend of $109,762 ($67,687 ÷ .61667), including a potential dividend refund of $42,075 [(38-1/3%)($109,762)]. The refund would be the lesser figure of $42,075.

As the corporate tax rate is higher than the 51 percent rate applicable to the direct receipt of interest income, the corporation does not provide any deferral on amounts left within the corporation. In this case, incorporation requires prepayment of taxes.

Using a corporation, she would be left with $62,455 in after tax funds. If she does not incorporate, the $143,000 in interest income would be taxed at 51 percent, leaving an after tax amount of $70,070. The tax cost of incorporation is $7,615 ($70,070 - $62,455).

Exam Exercise Solution Fifteen - 4 (Incorporation Of Interest Income)

Victor's personal tax rates are 51 percent on interest income and 42.3 percent [(117%)(51%) - (21/29 + 30%)(17%)] on non-eligible dividends. The corporate tax rate on investment income will be 51-2/3 percent (38% - 10% + 10-2/3% + 13%).

Using these tax rates, a comparison of the income retained with and without the use of a corporation is as follows:

	With Corporation	Without Corporation
Interest Income	$210,000	$210,000
Tax Rate	51-2/3%	51%
Tax Payable	$108,500	$107,100

	With Corporation	Without Corporation
Interest Income	$210,000	$210,000
Tax Payable	(108,500)	(107,100)
Net Corporate Income Before Dividend Refund	$101,500	N/A
Maximum Dividend Refund (See Note)	63,095	
Maximum Dividend Payable	$164,595	
Personal Tax On Dividends [(42.3%)($164,595)]	(69,624)	
Income Retained By Mr. Vice	$ 94,971	$102,900

RDTOH Balance [(30-2/3%)($210,000)]	$64,400

Note The dividend refund is the lesser of 38-1/3 percent of dividends paid and the balance in the RDTOH account. The available cash would support a dividend of $164,595 ($101,500 ÷ .61667), resulting in a potential dividend refund of $63,095 [(38-1/3%)($164,595)]. The lesser of the two figures is $63,095.

As the corporate rate of 51-2/3 percent is higher than Victor's personal rate of 51 percent, the use of a corporation provides requires prepayment of taxes and no deferral.

If the interest income is flowed through the corporation, there is a tax cost of $7,929 ($102,900 - $94,971). Clearly, transferring Victor's interest bearing investments to a corporation would not be a wise move.

Exam Exercise Solution Fifteen - 5 (Incorporation Of Interest And Dividends)

Direct Receipt

If the income is received directly, the total Tax Payable will be as follows:

Non-Eligible Dividends Received ($39,000 + $75,000)	$114,000
Gross Up At 17 Percent	19,380
Taxable Dividends	$133,380
Interest Income	36,500
Taxable Income	$169,880
Personal Tax Rate (33% + 16%)	49%
Tax Payable Before Dividend Tax Credit	$ 83,241
Dividend Tax Credit [(21/29 + 25%)($19,380)]	(18,879)
Personal Tax Payable	$ 64,362

The after tax retention can be calculated as follows:

Cash Received ($39,000 + $75,000 + $36,500)	$150,500
Tax Payable (See Calculation)	(64,362)
After Tax Retention - Direct Receipt	$ 86,138

Transfer To Corporation

The corporate tax rate on investment income will be 50-2/3 percent (38% - 10% + 10-2/3% + 12%). If the investments are transferred to a corporation, the corporate taxes will be as follows:

Part IV Tax On Dividends Received [(38-1/3%)($39,000) + $20,000]	$34,950
Tax On Interest Income [($36,500)(50-2/3%)]	18,493
Corporate Tax Payable Before Dividend Refund	$53,443

As this Tax Payable is less than the $64,362 that would be paid on the direct receipt of income, the use of a corporation would provide for a deferral of taxes. However, as the client needs all of the income produced by these investments, the use of a corporation to defer taxes is not relevant.

As this would be a new corporation, it would have no RDTOH balance at the beginning of the year. The RDTOH balance prior to the dividend refund would be calculated as follows:

Part IV Addition	$34,950
Part I Addition [(30-2/3%)($36,500)]	11,193
RDTOH Balance	$46,143

The dividend refund would be the lesser of 38-1/3 percent of dividends paid and the balance in the RDTOH account. The cash available after corporate taxes is $97,057 ($150,500 - $53,443). This would support a dividend of $157,390 ($97,057 ÷ .61667), with a potential dividend refund of $60,333 [(38-1/3%)($157,390)]. However, as the RDTOH balance is less than this, the refund would be $46,143.

After Tax Corporate Cash	$ 97,057
Dividend Refund (RDTOH Balance)	46,143
Non-Eligible Dividends Received	$143,200
Gross Up At 17 Percent	24,344
Taxable Dividends	$167,544
Personal Tax Rate	49%
Tax Before Dividend Tax Credit	$ 82,097

Dividend Tax Credit [(21/29 + 25%)($24,344)]	(23,714)
Personal Tax Payable	$ 58,383

After tax retention with the use of a corporation would be $84,817 ($143,200 - $58,383). This is $1,321 less than the $86,138 that would be retained through direct receipt of this income.

You should advise your client that using a corporation would result in an overall tax cost, making it not advisable to transfer her assets to a corporation.

Exam Exercise Solution Fifteen - 6 (Incorporation Of Interest And Dividends)

Direct Receipt Of Income

If the income is received directly, the total Tax Payable will be as follows:

Non-Eligible Dividends Received ($102,000 + $96,000)	$198,000
Gross Up At 17 Percent	33,660
Taxable Dividends	$231,660
Interest Income	71,000
Taxable Income	$302,660
Personal Tax Rate	49%
Tax Payable Before Dividend Tax Credit	$148,303
Dividend Tax Credit [(21/29 + 8/29)($33,660)]	(33,660)
Personal Tax Payable	$114,643

The after tax retention can be calculated as follows:

Cash Received ($71,000 + $102,000 + $96,000)	$269,000
Tax Payable	(114,643)
After Tax Retention - Direct Receipt	$154,357

Flowed Through A Corporation

The corporate tax rate on investment income will be 50-2/3 percent (38% - 10% + 10-2/3% + 12%). If the investments are transferred to a corporation, the corporate taxes will be as follows:

Part IV Tax On Dividends Received [(38-1/3%)($102,000) + $23,000]	$62,100
Tax On Interest Income [($71,000)(50-2/3%)]	35,973
Corporate Tax Payable Before Dividend Refund	$98,073

As this Tax Payable is smaller than the $114,643 that would be paid on the direct receipt of income, the use of a corporation provides for deferral of taxes. However, as the individual needs all of the income produced by these investments, the use of a corporation to defer taxes is not an issue.

As this would be a new corporation, it would have no RDTOH balance at the beginning of the year. The RDTOH balance prior to the dividend refund would be calculated as follows:

Part IV Addition	$62,100
Part I Addition [(30-2/3%)($71,000)]	21,773
RDTOH Balance	$83,873

The dividend refund is the lesser of the balance in the RDTOH account and 38-1/3 percent of dividends paid. The available cash of $170,927 ($269,000 - $98,073) would support a dividend of $277,177 ($170,927 ÷ .61667), including a potential dividend refund of $106,251 [(38-1/3%)($277,177)]. However, this amount is larger than the RDTOH balance and, given this, the refund would be $83,873.

Personal tax payable on these dividends would be calculated as follows:

After Tax Corporate Cash	$170,927
Dividend Refund (RDTOH Balance)	83,873
Non-Eligible Dividends Received	$254,800
Gross Up At 17 Percent	43,316
Taxable Dividends	$298,116
Personal Tax Rate	49%
Tax Before Dividend Tax Credit	$146,077
Dividend Tax Credit [(21/29 + 8/29)($43,316)]	(43,316)
Personal Tax Payable	$102,761

After tax retention with the use of a corporation would be $152,039 ($254,800 - $102,761). This is $2,318 ($154,357 - $152,039) less than the amount that Max would have retained on the direct receipt of income. You should advise Max that transferring his investments to a corporation has a tax cost.

Exam Exercise Solution Fifteen - 7 (Incorporation Of Capital Gains)

Direct Receipt Of Income Ms. Peterson's personal tax rate would be 51 percent (33% + 18%). Based on this, the after tax amount retained on direct receipt of income can be calculated as follows:

Capital Gain	$142,000
Personal Taxes [(51%)(1/2)($142,000)]	(36,210)
After Tax Retention - Direct Receipt	$105,790

Flowed Through A Corporation The corporation's tax rate on investment income would be 54-2/3 percent (38% - 10% + 10-2/3% + 16%). Based on this, the maximum distribution that can be made to Ms. Peterson would be calculated as follows:

Available Cash	$142,000
Corporate Tax Payable [(54-2/3%)(1/2)($142,000)]	(38,813)
Tax Free Capital Dividend [(1/2)($142,000)]	(71,000)
Available For Non-Eligible Dividend	$ 32,187
Dividend Refund (See Note)	20,008
Non-Eligible Dividend Received	$ 52,195
RDTOH Balance [(30-2/3%)($71,000)]	$ 21,774

Note The dividend refund is the lesser of the balance in the RDTOH account and 38-1/3 percent of the dividends paid. The available cash of $32,187 would support a dividend of $52,195 ($32,187 ÷ .61667), which includes a dividend refund of $20,008 [(38-1/3%)($52,195)]. The lesser of the two figures is $20,008.

Ms. Peterson's tax rate on non-eligible dividend income is 42.7 percent [(117%)(51%) - (21/29 + 8/29)(17%)]. Based on this, the net after tax retention when a corporation is used would be as follows:

Tax Free Capital Dividend Received [(1/2)($142,000)]	$ 71,000
Non-Eligible Dividend Received	52,195
Tax Payable On Non-Eligible Dividend [(42.7%)($52,195)]	(22,287)
After Tax Retention - With Corporation	$100,908

As this is less than the after tax cash retained of $105,790 on the direct receipt of the income, the use of a corporation to hold these investments is not an appropriate choice. Note that, as the client needs all of the income produced by these investments, the use of a corporation to defer taxes is not an issue.

Exam Exercise Solution Fifteen - 8 (Incorporation Of Capital Gains)

Direct Receipt Of Income Based on his personal tax rate of 52 percent, the amount retained on the direct receipt of income would be as follows:

Capital Gain [($640,000 - $420,000)]	$220,000
Personal Taxes [(52%)(1/2)($220,000)]	(57,200)
After Tax Retention - Direct Receipt	$162,800

Flowed Through A Corporation The corporation's tax rate on investment income would be 52-2/3 percent (38% - 10% + 10-2/3% + 14%). Based on this, the maximum distribution that can be made to Mr. Barkin would be calculated as follows:

Capital Gain ($640,000 - $420,000)	$220,000
Corporate Tax Payable [(52-2/3%)(1/2)($220,000)]	(57,933)
Tax Free Capital Dividend [(1/2)($220,000)]	(110,000)
Available For Non-Eligible Dividend	$ 52,067
Dividend Refund (See Note)	32,366
Non-Eligible Dividend Received	$ 84,433
RDTOH Balance [(30-2/3%)($110,000)]	$ 33,733

Note The dividend refunds is the lesser of the balance in the RDTOH account and 38-1/3 percent of the dividends paid. The available cash of $52,067 would support a dividend of $84,433 ($52,067 ÷ .61667), including a dividend refund of $32,366 [(38-1/3%)($84,433)]. The lesser of the two figures is $32,366.

Mr. Barkin's tax rate on non-eligible dividend income is 44.3 percent [(117%)(52%) - (21/29 + 25%)(17%)]. Based on this, the net after tax retention when a corporation is used would be as follows:

Tax Free Capital Dividend Received	$110,000
Non-Eligible Dividend Received	84,433
Tax Payable On Non-Eligible Dividend Received [(44.3%)($84,433)]	(37,404)
After Tax Retention - With Corporation	$157,029

As the corporate taxes of $57,933 are higher than the $57,200 that would be paid on direct receipt of the income, the use of a corporation does not provide tax deferral.

With respect to tax savings, the $157,029 of after tax cash retained with the use of a corporation is less than the $162,800 that was retained when the gain was realized at the personal level. There is, in fact, a tax cost of $5,771 ($162,800 - $157,029) associated with the use of a corporation.

Exam Exercise Solution Fifteen - 9 (Shareholder Loans)

The $25,000 loan is the same as any other employee loan and is exempt from inclusion in income under ITA 15(2). However, it is an interest free loan and will result in a current year taxable benefit for Ms. Thiessen of $375 [($25,000)(2% - Nil)(9/12)]. Because Ms. Thiessen received the loan in her capacity as an employee, the benefit can be calculated under ITA 80.4(1). This means that for the first five years of the loan, the benefit calculation will use a rate no higher than the prescribed rate that prevailed when the loan was made.

The $15,000 loan is unavailable to other employees and will be subject to the general rule under ITA 15(2) as Ms. Thiessen is a specified employee. However, there is an exception for the one-quarter of the loan that will be repaid prior to the end of the following taxation year of the corporation. This means that, while three-quarters of the loan, or $11,250, will have to be included in income in the current year, the remaining one-quarter, or $3,750, can be left out of income. However, this latter amount will attract a current year taxable benefit of $56.25 [($3,750)(2% - Nil)(9/12)].

This means the total income for the current year is $11,681.25 ($375 + $11,250 + $56.25).

Exam Exercise Solution Fifteen - 10 (Shareholder Loans)

As the $30,000 vehicle loan is available to all employees, it will not be included in Mr. Baxter's Net Income For Tax Purposes. However, as the loan is interest free, there will be a taxable benefit of $600 [($30,000)(2% - Nil)(12/12)]. Some portion of this taxable benefit may be deductible as it relates to the acquisition of an automobile to be used in employment duties.

With respect to the housing loan, such loans are not available to all employees and, because none of the loan will be repaid prior to the Company's second taxation year end, all of the $250,000 will be included in Mr. Baxter's income. Because all of the loan has been included in Mr. Baxter's Net Income For Tax Purposes, there will be no taxable benefit related to imputed interest on the housing loan.

Exam Exercise Solution Fifteen - 11 (Salary Compensation)

If the full $197,000 is paid out as salary, it will be deductible and will reduce the Company's Taxable Income to nil. This means that no corporate taxes will be paid. This salary payment will result in Ms. Cloister having Taxable Income of $197,000. Given this, her Tax Payable will be calculated as follows:

Combined Tax On First $140,388 ($29,029 + $15,500)	$ 44,529
Combined Tax On Remaining $56,612 ($197,000 - $140,388) At 41% (29% + 12%)	23,211
Combined Tax Payable Before Credits	$67,740
Personal Tax Credits (Given)	(3,375)
Personal Tax Payable	$64,365

Based on the preceding Tax Payable, Ms. Cloister's after tax retention would be $132,635 ($197,000 - $64,365), ignoring CPP contributions and the Canada employment credit.

Exam Exercise Solution Fifteen - 12 (Salary Compensation)

If all of the income is paid out as deductible salary, the Company will pay no taxes. The salary payment will result in Mr. Lisgar having Net Income For Tax Purposes and Taxable Income of $325,000. The Tax Payable on this income would be calculated as follows:

Combined Tax On First $200,000 ($46,317 + $27,000)	$ 73,317
Combined Tax On Remaining $125,000 ($325,000 - $200,000)	
At 49% (33% + 16%)	61,250
Combined Tax Payable Before Credits	$134,567
Personal Tax Credits (Given)	(4,550)
Personal Tax Payable	$130,017

Based on these calculations, Mr. Lisgar will have after tax retention of $194,983 ($325,000 - $130,017). This result ignores CPP contributions, as well as the Canada employment tax credit.

Exam Exercise Solution Fifteen - 13 (Dividend Compensation)

As dividends are not deductible for tax purposes, corporate taxes will have to be paid prior to the payment of any dividends. All of the $197,000 would be eligible for the small business deduction and the applicable rate would be 15.5 percent (38% - 10% - 17.5% + 5%). Given this, the maximum dividend that could be paid would be calculated as follows:

Corporate Taxable Income	$197,000
Corporate Taxes At 15.5 Percent	(30,535)
Funds Available For Dividends	$166,465

Personal taxes on this dividend would be calculated as follows:

Non-Eligible Dividends Received	$166,465
Gross Up At 17 Percent	28,299
Taxable Dividends	$194,764

Combined Tax On First $140,388 ($29,029 + $15,500)	$ 44,529
Combined Tax On Remaining $54,376 ($194,764 - $140,388)	
At 41% (29% + 12%)	22,294
Combined Tax Payable Before Credits	$ 66,823
Personal Tax Credits (Given)	(3,375)
Dividend Tax Credit [(21/29 + 8/29)($28,299)]	(28,299)
Personal Tax Payable	$ 35,149

The after tax retention would be equal to $131,316 ($166,465 - $35,149).

Exam Exercise Solution Fifteen - 14 (Dividend Compensation)

As dividends are not deductible for tax purposes, corporate taxes will have to be paid prior to the payment of any dividends. All of the income would be eligible for the small business deduction and Lisgar's corporate tax rate is 14 percent (38% - 10% - 17.5% + 3.5%). Given this, the maximum dividend that could be paid is calculated as follows:

Corporate Taxable Income	$325,000
Corporate Taxes At 14 Percent	(45,500)
Funds Available For Dividends	$279,500

Mr. Lisgar's personal taxes on this income would be calculated as follows:

Non-Eligible Dividends Received	$279,500
Gross Up At 17 Percent	47,515
Taxable Dividends	$327,015

Combined Tax On First $200,000 ($46,317 + $27,000)	$ 73,317
Combined Tax On Remaining $127,015 ($327,015 - $200,000) At 49% (33% + 16%)	62,237
Combined Tax Payable Before Credits	$135,554
Personal Tax Credits (Given)	(4,550)
Dividend Tax Credit [(21/29 + 25%)($47,515)]	(46,286)
Personal Tax Payable	$ 84,718

The after tax retention would be $194,782 ($279,500 - $84,718).

Exam Exercise Solution Fifteen - 15 (Salary Vs. Dividends)

Salary Alternative As the available cash is less than Taxable Income, some corporate taxes will have to be paid since there is insufficient cash to pay a salary equivalent to Taxable Income. To determine the maximum salary that can be paid (X), it is necessary to solve the following equation:

$$X = \$17,300 - [(\$23,600 - X)(15\%)]$$

$$X = \underline{\underline{\$16,188}}$$

Corporate taxes of $1,112 [(15%)($23,600 - $16,188)] would have to be paid. The total cash outflow equals the cash available of $17,300 ($16,188 + $1,112).

Given this salary, Ms. Ramsden would be subject to the following personal Tax Payable:

Tax Payable Before Credits [(15% + 11%)($16,188)]	$4,209
Available Tax Credits (Given)	(4,120)
Personal Tax Payable On Salary	$ 89

Given the preceding Tax Payable, Ms. Ramsden's after tax retention on salary would be $16,099 ($16,188 - $89).

Dividend Alternative As dividends are not deductible, corporate taxes would have to be paid on the full $23,600. These taxes would be $3,540 [(15%)($23,600)], leaving an amount available for dividends of $13,760 ($17,300 - $3,540). As no individual taxes would be payable on this amount of dividends, the full $13,760 would be retained.

Given these calculations, it is clear that the preferred approach is to pay the maximum salary. Note, however, some combination of dividends and salary may provide an even better result.

Exam Exercise Solution Fifteen - 16 (Salary Vs. Dividends)

Salary Alternative If all of the $35,200 in cash is removed as salary, no corporate taxes will be paid. In fact, the removal of this amount of cash as salary will create a loss of $700 ($35,200 - $34,500) for the Company which can be carried back to claim a refund of $91 [(13%)($700)]. If Bryan receives the $35,200 as salary, his after tax retention can be calculated as follows:

Salary Received	$35,200
Tax Payable [(51%)($35,200)]	(17,952)
After Tax Amount Retained - Salary	$17,248

Dividend Alternative If all of the $35,200 is paid out as dividends, there would be corporate Tax Payable on the $34,500 of Taxable Income. The amount available as a dividend would be calculated as follows:

Available Cash	$35,200
Tax Payable [(13%)($34,500)]	(4,485)
Funds Available For Dividend	$30,715

Bryan's tax rate on non-eligible dividends would be 44% [(117%)(51%) - (21/29 + 20%)(17%)]. Given this, his after tax retention of the dividend income would be calculated as follows:

Non-Eligible Dividends Received	$30,715
Tax Payable On Dividends [(44%)($30,715)]	(13,515)
After Tax Retention - Dividends	$17,200

The dividend alternative provides after tax retention of $17,200. As this is $48 ($17,248 - $17,200) less than the amount retained with the salary alternative, the salary alternative is preferable. The $91 tax refund to the corporation due to the salary would reinforce this conclusion.

Exam Exercise Solution Fifteen - 17 (Salary Vs. Dividends)

Required Salary Mr. Hughes' combined tax rate on additional salary is 49 percent (33% + 16%). In order to have $17,000 in after tax funds, he would have to receive salary of $33,333 [$17,000 ÷ (1 - .49)].

Tax Cost Of Salary The net tax cost of paying salary can be calculated as follows:

Personal Tax On Receipt Of Salary [(49%)($33,333)]	$16,333
Tax Savings To Corporation [(14%)($33,333)]	(4,667)
Net Tax Cost Of Salary	$11,666

Required Dividend Mr. Hughes' tax rate on non-eligible dividends is 41.1 percent [(117%)(49%) - (21/29 + 23%)(17%)]. In order to have $17,000 in after tax funds, he would have to receive dividends of $28,862 [$17,000 ÷ (1 - .411)].

Tax Cost Of Dividend As the dividend payment would not be deductible, its payment would not change corporate taxes. This means that the tax cost would be the $11,862 [(41.1%)($28,862)] in personal taxes that Mr. Hughes would pay on the dividends received.

Conclusion As the tax cost of the dividend alternative is $196 ($11,862 - $11,666) higher, salary should be paid.

Exam Exercise Solution Fifteen - 18 (Salary Vs. Dividends)

Required Salary Miriam's combined tax rate is 51 percent on any additional salary. Given this, in order to retain $50,000, she will need salary of $102,041 [$50,000 ÷ (1 - 51%)].

Tax Cost Of Salary The net tax cost of paying salary can be calculated as follows:

Personal Tax On Receipt Of Salary [(51%)($102,041)]	$52,041
Tax Savings To Corporation [(14%)($102,041)]	(14,286)
Net Tax Cost Of Salary	$37,755

Required Dividend Miriam's tax rate on non-eligible dividends is 42.7 percent [(117%)(51%) - (21/29 + 8/29)(17%)]. In order to have $50,000 in after tax funds, she would have to receive dividends of $87,260 [$50,000 ÷ (1 - .427)].

Tax Cost Of Dividend As the dividend payment would not be deductible, its payment would not change corporate taxes. This means that the tax cost would be the $37,260 [(42.7%)($87,260)] in personal taxes that Miriam would pay on the dividends received.

Conclusion As the net tax cost associated with the payment of salary is larger, the dividend alternative would have the lower tax cost.

TIF Solution Fifteen - 5A

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

A. 5

B. 9

C. 1

D. 10

E. 4

F. 8

G. 6

H. 3

The two unused definitions are as follows:

Aggregate Investment Income = 7

General Rate Income Pool (GRIP) = 2

TIF Solution Fifteen - 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. 8

B. 13 (not 2)

C. 1

D. 14 (not 7)

E. 6 (not 12)

F. 11 (not 4)

G. 9

H. 5

The two unused definitions are as follows:

Aggregate Investment Income = 10

General Rate Income Pool (GRIP) = 3

TIF Solution Fifteen - 6

Part A - Direct Personal Investment

Ms. Naidu's marginal tax rate is 45 percent (29% + 16%). If Ms. Naidu invests the $175,000 as an individual, the after tax return can be calculated as follows:

Interest Income (All Taxable)	$5,250
Interest Received	$5,250
Personal Tax Payable At 45 Percent	(2,363)
After Tax Retention	$2,887

Part B - Investment Through Private Company

If Ms. Naidu invests the $175,000 through her private company, any dividends paid will be non-eligible. The after tax return would be as follows:

Interest Income	$5,250
Corporate Taxes At 50-2/3 Percent	(2,660)
Net Corporate Income Before Dividend Refund	$2,590
Maximum Dividend Refund (See Note)	1,610
Maximum Non-Eligible Dividend Payable	$4,200
Gross Up At 17 Percent	714
Taxable Dividend	$4,914
Personal Tax Rate	45%
Personal Tax Payable Before Dividend Tax Credit	$2,211
Dividend Tax Credit [(21/29 + 30%)($714)]	(731)
Personal Tax Payable	$1,480
Dividends Received	$4,200
Personal Tax Payable	(1,480)
After Tax Retention	$2,720

Note The available cash would support a dividend of $4,200 ($2,590 ÷ .61667), including a dividend refund of $1,610 [(38-1/3%)($4,200)]. As this is equal to the $1,610 [(30-2/3%)($5,250)] balance in the RDTOH, this amount of dividends can be paid.

The difference between the two alternatives is $167 ($2,887 - $2,720) in favour of direct personal investment.

TIF Solution Fifteen - 7

Part A - Direct Personal Investment

Ms. Abdul's marginal tax rate is 52 percent (33% + 19%). If she invests the $400,000 as an individual, the after tax return can be calculated as follows:

Eligible Dividends Received [($400,000)(5.5%)]	$22,000
38 Percent Gross Up	8,360
Taxable Dividend	$30,360
Personal Tax Rate	52%
Personal Tax Payable Before Dividend Tax Credit	$15,787
Dividend Tax Credit [(6/11 + 28%)($8,360)]	(6,901)
Personal Tax Payable	$ 8,886

Dividends Received	$22,000
Personal Tax Payable	(8,886)
After Tax Retention - Direct Receipt	$13,114

Part B - Investment Through Private Company

If Ms. Abdul invests the $400,000 through her private company, the eligible dividends received would be classified as portfolio dividends, subject to Part IV tax at 38-1/3 percent. There would also be an addition to the corporation's GRIP account of $22,000 (notice that eligible dividends are not multiplied by 72 percent for the GRIP addition). The after tax retention on the flow through the corporation would be as follows:

Eligible Dividends Received	$22,000
Part IV Tax At 38-1/3 Percent (Portfolio Dividends)	(8,433)
Earnings Retained By Corporation	$13,567
Refund When Dividends Paid (See Note)	8,433
Eligible Dividends Paid (See Note)	$22,000

Note The available cash would support a dividend of $22,000 ($13,567 ÷ .61667), including a refund of $8,433 [(38-1/3%)($22,000)]. This refund is available as it is equal to the $8,433 balance in the RDTOH resulting from the payment of Part IV tax on the receipt of the dividends.

At this point, the corporation has paid no net amount of taxes and will be paying exactly the same amount of eligible dividends that it received. This will result in Ms. Abdul paying exactly the same amount of taxes that she would have paid on direct receipt of the dividends. With the use of a corporation, the after tax retention would be identical to the after tax retention resulting from direct receipt of the dividends.

TIF Solution Fifteen - 8

Part A - Direct Personal Investment

Carol's marginal tax rate is 43 percent (29% + 14%). If she invests the $600,000 as an individual, the after tax return can be calculated as follows:

Interest Income [(4%)($600,000)]	$24,000
Personal Tax Payable [(43%)($24,000)]	(10,320)
After Tax Retention - Direct Receipt	$13,680

Part B - Investment Through Private Company

The combined federal/provincial tax rate on the investment income of the corporation is 51-2/3 percent (28% + 13% + 10-2/3%). Given this, Carol's after tax return would be calculated as follows:

Interest Income	$24,000
Corporate Taxes At 51-2/3 Percent	(12,400)
Net Corporate Income Before Dividend Refund	$11,600
Maximum Dividend Refund (See Note)	7,210
Maximum Non-Eligible Dividend Payable	$18,810
Gross Up At 17 Percent	3,198
Taxable Dividend	$22,008
Personal Tax Rate	43%
Personal Tax Payable Before Dividend Tax Credit	$ 9,463
Dividend Tax Credit [(21/29 + 24%)($3,198)]	(3,083)
Personal Tax Payable	$ 6,380

Dividends Received	$18,810
Personal Tax Payable	(6,380)
After Tax Retention - With Corporation	$12,430

Note The available cash would support a dividend of $18,810 ($11,600 ÷ .61667), including a dividend refund of $7,210 [(38-1/3%)($18,810)]. As this is less than the $7,360 [(30-2/3%)($24,000)] balance in the RDTOH, this amount of dividends can be paid. There is additional refundable tax of $150 ($7,360 - $7,210) that is available, but only on the payment of additional dividends.

The difference between the two alternatives is $1,250 ($13,680 - $12,430) in favour of direct personal investment. Transferring the debt security to a CCPC would not be an appropriate alternative in this situation.

TIF Solution Fifteen - 9

Part A - Direct Personal Investment

Carol's marginal tax rate is 43 percent (29% + 14%). If she invests the $600,000 as an individual, the after tax return can be calculated as follows:

Eligible Dividends Received [($600,000)(5%)]	$30,000
38 Percent Gross Up	11,400
Taxable Dividend	$41,400
Personal Tax Rate	43%
Personal Tax Payable Before Dividend Tax Credit	$17,802
Dividend Tax Credit [(6/11 + 24%)($11,400)]	(8,954)
Personal Tax Payable	$ 8,848

Dividends Received	$30,000
Personal Tax Payable	(8,848)
After Tax Retention - Direct Receipt	$21,152

Part B - Investment Through Private Company

If Carol invests the $600,000 through her private company, the eligible dividends received would be classified as portfolio dividends, subject to Part IV tax at 38-1/3 percent. There would also be an addition to the corporation's GRIP account of $30,000 (notice that eligible dividends are not multiplied by 72 percent for the GRIP addition). The after tax retention on the flow through the corporation would be as follows:

Eligible Dividends Received	$30,000
Part IV Tax At 38-1/3 Percent (Portfolio Dividends)	(11,500)
Earnings Retained By Corporation	$18,500
Refund When Dividends Paid	11,500
Eligible Dividends Paid (See Note)	$30,000

Note The available cash would support a dividend refund of $30,000 ($18,500 ÷ .61667), including a refund of $11,500 [(38-1/3%)($30,000)]. This refund is available as the balance in the RDTOH account is also $11,500 [(38-1/3%)($30,000)].

As the dividend payment is equal to the GRIP balance, the full amount of $30,000 can be designated as eligible for the enhanced gross up and tax credit procedure.

At this point, the corporation has paid no net amount of taxes and will be paying exactly the same amount of eligible dividends that it received. This will result in Carol paying exactly the same amount of taxes that she would have paid on direct receipt of the dividends. With the use of a corporation, the after tax retention would be identical to the after tax retention resulting from direct receipt of the dividends.

TIF Solution Fifteen - 10

Approach 1

Harold Bates' share of the partnership income would $155,000 [(25%)($620,000)]. The Tax Payable on this income would be calculated as follows:

Tax On First $140,388 ($29,029 + $11,500)	$40,529
Tax On Next $14,612 ($155,000 - $140,388) At 41 Percent (29% + 12%)	5,991
Tax Payable Before Credits	$46,520
Personal Tax Credits - Given	(4,280)
Tax Payable	$42,240

The total after tax income is $112,760 ($155,000 - $42,240).

Approach 2

The total corporate taxes would be calculated as follows:

First $125,000 At 14 Percent	$17,500
Remaining $30,000 At 28 Percent	8,400
Total Corporate Tax	$25,900

If all of the after tax income is paid out, the resulting dividend will be $129,100 ($155,000 - $25,900). As $30,000 of the corporation's income was taxed at the general rate, there would be a GRIP balance of $21,600 [(72%)($30,000)]. This means that of the total dividend of $129,100, $21,600 could be designated as eligible, with the remaining $107,500 ($129,100 - $21,600) being non-eligible. Based on this, Harold's Taxable Income would be as follows:

Eligible Dividend	$21,600
Gross Up On Eligible Dividend At 38 Percent	8,208
Non-Eligible Dividend	107,500
Gross Up On Non-Eligible Dividend At 17 Percent	18,275
Total Taxable Income	$155,583

Based on this Taxable Income, his Tax Payable would be as follows:

Tax On First $140,388 ($29,029 + $11,500)		$40,529
Tax On Next $15,195 ($155,583 - $140,388) At 41 Percent (29% + 12%)		6,230
Tax Payable Before Credits		$46,759
Personal Tax Credits - Given		(4,280)
Dividend Tax Credits		
[(6/11 + 30%)($8,208)]	($ 6,939)	
[(21/29 + 30%)($18,275)	(18,716)	(25,655)
Tax Payable		$16,824

The total after tax income is $112,276 ($21,600 + $107,500 - $16,824).

Approach 3

With the payment of $30,000 in salaries to reduce corporate income to his $125,000 share of the small business deduction, corporate taxes would be $17,500 [(14%)($125,000)]. This would leave $107,500 ($155,000 - $30,000 - $17,500) for the payment of dividends.

Since no income was taxed at the general rate, the GRIP balance would be nil. This means that the total dividend of $107,500 would be non-eligible. Harold's Taxable Income would be calculated as follows:

Salary	$ 30,000
Non-Eligible Dividend	107,500
Gross Up On Non-Eligible Dividend At 17 Percent	18,275
Taxable Income	$155,775

Based on this Taxable Income, Harold's Tax Payable would be calculated as follows:

Tax On First $140,388 ($29,029 + $11,500)	$40,529
Tax On Next $15,387 ($155,775 - $140,388)	
At 41 Percent (29% + 12%)	6,309
Tax Payable Before Credits	$46,838
Personal Tax Credits - Given	(4,280)
Dividend Tax Credit [(21/29 + 30%)($18,275)	(18,716)
Tax Payable	$23,842

The total after tax income is $113,658 ($30,000 + $107,500 - $23,842).

Evaluation

The after tax amount retained for each of the three approaches is as follows:

Approach 1 (Joins Partnership As Individual)	$112,760
Approach 2 (All Dividends)	112,276
Approach 3 (Salary And Dividends)	113,658

In this analysis, Approach 3 provides the largest amount of after tax retention for Harold and would be the best approach.

TIF Solution Fifteen - 11

Part A - No Corporation

Assuming that Judith continues to hold all of the investments personally, the after tax retention for each investment is as follows:

Interest Received	$12,000
Tax Payable [(52%)($12,000)]	(6,240)
After Tax Retention (48%)	$ 5,760

Capital Gains Received	$30,000
Tax Payable [(52%)(1/2)($30,000)]	(7,800)
After Tax Retention (74%)	$22,200

Eligible Portfolio Dividends Received	$40,000
Tax Payable [(30%)($40,000)]	(12,000)
After Tax Retention (70%)	$28,000

Part B - Interest Income

The calculations here would be as follows:

Interest Income	$12,000
Corporate Taxes At 51-2/3 Percent	(6,200)
Cash Available For Dividends	$ 5,800
Dividend Refund - Lesser Of:	
• [(30-2/3%)($12,000)] = $3,680	
• [($5,800 ÷ .61667) - $5,800] = $3,605	3,605
Non-Eligible Dividend Payment	$9,405
Personal Taxes At 40 Percent	(3,762)
After Tax Retention	$5,643

Judith's personal rate at 52 percent is only marginally higher than the corporate rate of 51-2/3 percent. There is no significant amount of deferral available.

If Judith had received the interest directly, she would have retained $5,760 (see Part A). As this amount is $117 more than the retention with a corporation, the use of a corporation provides no tax savings in this case.

Part B - Capital Gains

The calculations here would be as follows:

Taxable Capital Gains [(1/2)($30,000)]	$15,000
Corporate Taxes At 52 Percent	(7,800)
Cash Available For Taxable Dividends	$ 7,200
Dividend Refund - Lesser Of:	
• [(30-2/3%)($15,000)] = $4,600	
• [($7,200 ÷ .61667) - $7,200] = $4,476	4,476
Non-Eligible Dividend Payment	$11,676
Personal Taxes At 40 Percent	(4,670)
After Tax Retention Of Dividends	$ 7,006
Tax Free Capital Dividend	15,000
Total After Tax Retention	$22,006

Judith's personal rate at 52 percent is only marginally higher than the corporate rate of 51-2/3 percent. There is no significant amount of deferral available.

If Judith had received the capital gains directly, she would have retained $22,200 (see Part A). As this amount is $194 more than the retention with a corporation, the use of a corporation provides no tax savings in this case.

Part B - Eligible Portfolio Dividends

The eligible portfolio dividends would be subject to Part IV Tax of 38-1/3 percent. As this rate is considerably higher than the 30 percent rate that she would pay on eligible dividends, there would be no deferral of tax at the corporate level.

Calculations here would be as follows:

Portfolio Dividends Received	$40,000
Part IV Tax [(38-1/3%)($40,000)]	(15,333)
Available For Dividends	$24,667
Dividend Refund [($24,667 ÷ .61667) - $24,667]	(15,333)
Total After Tax Retention	$40,000

After the payment of dividends, there is no net tax on the corporation. In addition, the eligible dividends received by the CCPC would be added to its GRIP, allowing them to be passed through to Judith as eligible dividends. As a consequence, the total tax using a corporation is the same as would apply if Judith had received the dividends directly. There is no tax savings through the use of a corporation.

TIF Solution Fifteen - 12

Part A - Tax Consequences

Loan 1 - Taxable Benefit

As such loans are available to all employees, Hannah can claim that she has received the loan in her capacity as an employee. This means that the $200,000 principal does not have to be included in her 2016 Net Income For Tax Purposes. However, as the loan is interest free, there will be a taxable benefit included in Hannah's Net Income For Tax Purposes as follows:

2016 [($200,000)(2%)(10/12)]	$3,333.33
2017 [($200,000)(2%)(2/12) + ($200,000 - $100,000)(2%)(10/12)]	$2,333.33
2018 [($200,000 - $100,000)(2%)(2/12)]	$333.33

Loan 2 - Principal In Income

While the term of the loan is consistent with the loans being given to other employees, the principal amount is far in excess of anything being provided to other employees. Given this, it is clear that the loan is being extended to Hannah as the sole shareholder, not as an employee.

This means that the $185,000 principal amount would have to be included in her 2016 Net Income For Tax Purposes. When the loan is repaid in 2021, the $185,000 can be deducted from her Net Income For Tax Purposes.

As the principal amount is included in her income, there will be no taxable benefit for imputed interest associated with the loan.

Loan 3 - Taxable Benefit

As the loan is repaid prior to December 31, 2017 (the second corporate year end), the principal amount does not have to be included in Hannah's 2016 Net Income For Tax Purposes. However, as it is interest free, there will be a taxable benefit for imputed interest as follows:

2016 [(2%)($40,000)(6/12)]	$400
2017 [(2%)($40,000)(6/12)]	$400

Although the loan is being used to pay for medical expenses that will qualify for the medical expense tax credit, interest, or imputed interest on loans to fund medical expenses is not an allowable medical expense.

Loan 4 - Principal In Income

As this loan is not repaid prior to December 31, 2017 (the second corporate year end), it has to be included in Hannah's 2016 Net Income For Tax Purposes.

In 2018, the year it is repaid, the $100,000 can be deducted from her Net Income For Tax Purposes.

As the principal amount is included in her income, there will be no taxable benefit for imputed interest associated with the loan.

Loan 5 - No Effect

This loan is repaid prior to its inclusion in a second corporate Balance Sheet. As a consequence, the principal amount does not have to be included in Hannah's 2016 Net Income For Tax Purposes.

As the interest rate of 3 percent on the loan is higher than the prescribed rate, there will be no imputed interest benefit.

Part B - Tax Planning Issues

Loan 1

There are no issues here in that the loan is structured to be consistent with other loans to employees. This allows Hannah to receive a home loan on an interest free basis and, because she has received it as a result of her employee status, she does not have to include the principal in her Net Income For Tax Purposes.

Loan 2

As the loan must be included in her Net Income For Tax Purposes, it is not good tax planning for Hannah to pay any interest. The interest will be taxed at the corporate level, likely at the unfavourable rates applicable to investment income due to the size and terms of the loan.

As the car is used only for personal purposes, she cannot deduct any of the interest paid. If she paid no interest on the loan, her tax situation would not be changed and the corporation would pay less taxes.

Loan 3

The fact that the loan was interest free resulted in Hannah having a taxable benefit. If she had paid interest at the prescribed rate, the benefit could have been reduced or eliminated. However, the corporation would be taxed on the interest and she cannot deduct or claim it as a medical expense.

Whether making the loan on an interest free basis represents good tax planning depends on whether the corporation's tax rate on investment income is higher than the tax rate applicable to Hannah. If it is higher, using an interest free rate could represent good tax planning.

Loan 4

As the principal of the loan must be included in income, the tax planning question is whether it would have been more appropriate to simply pay an equivalent amount of salary to Hannah. The advantage of the loan is that it can be repaid and deducted in future years. In contrast, salary cannot be returned to the corporation, but it is deductible to the corporation as salary.

Given that the principal of the loan is included in Hannah's income, making the loan interest free is the appropriate choice.

Loan 5

It was clearly not appropriate to pay interest at a rate higher than the prescribed rate. The extra 1 percent did not reduce Hannah's imputed interest benefit as it would be nil with a 2 percent interest rate. In addition, it will be taxed at the corporate level and Hannah cannot deduct the interest.

There is also the question of whether any interest should have been paid on the loan. Making it interest free would create a taxable benefit for Hannah. However, it would eliminate the need to pay corporate taxes on the interest received. As discussed under the comments on Loan 3, the answer to this question depends on the relative tax rates for Hannah as compared to the rate applicable to investment income received by the corporation.

TIF Solution Fifteen - 13

Part A - Tax Consequences

Loan 1

As such loans are available to all employees, Ms. Copps can claim that she has received the loan in her capacity as an employee. This means that the $150,000 principal does not have to be included in her 2016 Net Income For Tax Purposes. However, as the rate on the loan is below the prescribed rate, there will be a taxable benefit included in Ms. Copps' Net Income For Tax Purposes.

The amount to be accrued for 2016 is $1,375 [($150,000)(2% - 1%)(11/12)].

For 2017, the amount is $812.50

[($150,000)(2% - 1%)(1/12) + ($150,000 - $75,000)(2% - 1%)(11/12)].

For 2018, the amount is $62.50 [($150,000 - $75,000)(2% - 1%)(1/12)].

Loan 2

While the term of the loan and the applicable interest rate are consistent with the loans being given to other employees, the principal amount is far in excess of anything being provided to other employees. Given this, it is clear that the loan is being extended to Ms. Copps as the sole shareholder, not as an employee.

This means that the $349,000 principal amount would have to be included in her 2016 Net Income For Tax Purposes. When the loan is repaid in 2021, the $349,000 can be deducted from her Net Income For Tax Purposes.

As the principal amount is included in her income, there will be no taxable benefit for imputed interest associated with the loan.

Loan 3

As the loan is repaid prior to October 31, 2017 (the second corporate year end), the principal amount does not have to be included in Ms. Copps' 2016 Net Income For Tax Purposes. However, as it is interest free, there will be a taxable benefit for imputed interest.

For 2016, the amount will be $408 [(2%)($35,000)(7/12)].

For 2017, the benefit will be $292 [(2%)($35,000)(5/12)].

Loan 4

As this loan is not repaid prior to October 31, 2017 (the second corporate year end), it has to be included in Ms. Copps' 2016 Net Income For Tax Purposes.

In 2018, the year it is repaid, the $100,000 can be deducted from Ms. Copp's Net Income For Tax Purposes.

As the principal amount is included in her income, there will be no taxable benefit for imputed interest associated with the loan.

Loan 5

This loan is repaid prior to its inclusion in a second corporate Balance Sheet. As a consequence, the principal amount does not have to be included in Ms. Copps' 2016 Net Income For Tax Purposes.

As the interest rate of 3 percent on the loan is higher than the prescribed rate, there will be no imputed interest benefit.

Part B - Tax Planning Issues

Loan 1

There are no issues here in that the loan is structured to be consistent with other loans to employees. This allows Ms. Copps to receive a home loan at a very favourable rate and, because she has received it as a result of her employee status, she does not have to include the principal in her Net Income For Tax Purposes.

Loan 2

As the loan must be included in her Net Income For Tax Purposes, it is not good tax planning for Ms. Copps to pay any interest. The interest will be taxed at the corporate level, likely at the unfavourable rates applicable to investment income due to the size and terms of the loan.

As the car is used only for personal purposes, she cannot deduct any of the interest paid. If she had paid no interest on the loan, her tax situation would not be changed and the corporation would pay less taxes.

Loan 3

The fact that no interest is paid on the loan results in a taxable benefit for Ms. Copps. If she had paid interest, the benefit would be reduced. However, the corporation would be taxed on the interest received.

Whether making the loan on an interest free basis represents good tax planning depends on whether the corporation's tax rate is higher than the rate applicable to Ms. Copps. If it is higher, using an interest free loan could represent good tax planning.

Loan 4

As the principal of the loan must be included in income, the tax planning question is whether it would have been more appropriate to simply pay an equivalent amount of salary to Ms. Copps. The advantage of the loan is that it can be repaid and deducted in future years. In contrast, salary cannot be returned to the corporation, but it can be deducted by the Company for tax purposes.

Given that the principal of the loan is included in Ms. Copp's income, making the loan interest free is the appropriate choice.

Loan 5

It was clearly not appropriate to pay interest at a rate higher than the prescribed rate. The extra 1 percent did not reduce Mr. Copps' imputed interest benefit. In addition, it will be taxed at the corporate level.

There is also the question of whether any interest should have been paid on the loan. Making it interest free would create a taxable benefit for Ms. Copps. However, it would eliminate the need to pay corporate taxes on the interest received. As discussed under the comments on Loan 3, the answer to this question depends on the relative tax rates for Ms. Copps as compared to the rate applicable to investment income received by the corporation.

TIF Solution Fifteen - 14

Required Salary

Given her personal tax rate of 52 percent, a salary of $52,083 [($25,000 ÷ (1 - .52)] would be required to provide Jeannette with an additional $25,000 in after tax funds.

Tax Cost Of Salary Alternative

The net tax cost of this alternative would be calculated as follows:

Personal Taxes On Salary [(52%)($52,083)]	$27,083
Tax Savings To Corporation [(14%)($52,083)]	(7,292)
Net Tax Cost Of Salary Alternative	$19,791

Required Dividend

Jeannette's tax rate on non-eligible dividends would be calculated as follows:

[(117%)(52%) - (21/29 + 29%)(17%)] = 43.6%

This gives after tax retention of dividend income in the amount of 56.4 percent (1 - .436). This means a dividend of $44,326 ($25,000 ÷ .564) will be required to provide an additional $25,000 of after tax funds.

Tax Cost Of Dividend Alternative

The personal Tax Payable on the dividend would be calculated as follows:

Non-Eligible Dividends Received	$44,326
Gross Up At 17 Percent	7,535
Taxable Income	$51,861
Tax Rate	52%
Tax Payable Before Dividend Tax Credit	$26,968
Dividend Tax Credit [(21/29 + 29%)($7,535)]	(7,642)
Personal Tax Payable On Dividend Alternative	$19,326

Subtracting the Tax Payable of $19,326 from the dividends received of $44,326 gives the required $25,000 in after tax funds.

As the dividend payment would not be deductible, its payment would not change corporate taxes. This means that the only tax cost would be the $19,326 in personal taxes that Jeanette would pay on the dividends received.

Conclusion

The salary alternative has a net tax cost which is $435 ($19,791 - $19,326) higher than the tax cost of paying dividends. The dividend alternative would have the lower tax cost.

Since Jeanette has already received a salary of $212,000, CPP contributions and the Canada employment credit are not relevant to this analysis as they would have already been accounted for and would not affect the conclusion.

TIF Solution Fifteen - 15

Part A - Taxes And Salary

The combined federal/provincial tax rate applicable to Wasal Inc. would be 15 percent (38% - 10% - 17.5% + 4.5%).

As the corporation's Taxable Income exceeds the amount of cash available, the maximum amount of salary that can be paid (X) must be determined using the following simple equation:

X = $54,000 - [(15%)($135,000 - X)]

Solving this equation for X indicates that the maximum salary that can be paid is $39,706.

This can be verified by the following calculation:

Corporate Taxable Income Before Salary	$135,000
Maximum Salary	(39,706)
Corporate Taxable Income After Salary	$ 95,294
Corporate Rate	15%
Corporate Tax Payable	$ 14,294

Payment of this amount of taxes will leave $39,706 ($54,000 - $14,294) available for the payment of salary.

With this amount of salary, Waylon would have the following amount of after tax cash:

Salary Payment		$39,706
Tax Before Credits [(15% + 8%)($39,706)]	($9,132)	
Personal Tax Credits (Given)	4,200	(4,932)
After Tax Cash Retained (All Salary)		$34,774

Part B - All Dividends

As dividend payments are not deductible to the Company, taxes of $20,250 [(15%)($135,000)] will have to be paid. This leaves a maximum of $33,750 ($54,000 - $20,250) to be used for the payment of non-eligible dividends. When this is paid, the after tax retention by Waylon will be as follows:

Non-Eligible Dividends Received	$33,750
Gross Up [(17%)($33,750)]	5,738
Taxable Dividends	$39,488
Personal Tax Rate (15% + 6%)	23%
Tax Payable Before Credits	$ 9,082
Personal Tax Credits (Given)	(4,200)
Dividend Tax Credit [(21/29 + 32%)($5,738)]	(5,991)
Tax Payable	Nil

As there is no Tax Payable, Waylon will retain all of the $33,750 in dividends.

Part C - Possible Improvement

While the Tax Payable for Waylon is nil in Part B, subtracting personal and dividend tax credits from the tax balance gives a negative figure of $1,109. This means that the all dividend approach leaves unused tax credits. While not conclusive, this suggests that there may be a better solution than either all salary or all dividends.

Part D - Salary/Dividend Combination

To examine the possibility of an optimum solution using both salary and dividends, consider the result that occurs when $1,000 in salary is paid in lieu of some dividends. Because the deductible salary payment would reduce corporate taxes, dividends would only have to be decreased by $850 [($1,000)(1 - 0.15)]. The tax effects of this switch can be calculated as follows:

Increase In Salary	$1,000.00
Decrease In Dividend [($1,000)(1 - .15)]	(850.00)
Decrease In Dividend Gross Up [(17%)($850.00)]	(144.50)
Increase In Waylon's Taxable Income	$ 5.50
Personal Tax Rate	23%
Increase In Tax Payable Before Dividend Tax Credit	$ 1.265
Decrease In Dividend Tax Credit [(21/29 + 32%)($144.50)]	150.878
Net Increase In Personal Tax Payable	$ 152.143

The rate on a $1,000 increase in salary is 152.143 percent ($152.143 ÷ $1,000). Applying this rate to the unused credits of $1,109 (see Part C), gives a required increase in salary of $7,289 ($1,109 ÷ .152143).

Payment of this amount of salary would result in corporate Tax Payable as follows:

Corporate Taxable Income Before Salary	$135,000
Salary	(7,289)
Corporate Taxable Income After Salary	$127,711
Corporate Rate	15%
Corporate Tax Payable	$ 19,157

Based on available cash of $54,000, the amount of dividend that could be paid is as follows:

Cash Available	$54,000
Corporate Tax Payable	(19,157)
Salary Payment	(7,289)
Available For Dividends	$27,554

After tax retention at the personal level would be calculated as follows:

Non-Eligible Dividends Received	$27,554
Gross Up [(17%)($27,554)]	4,684
Taxable Dividends	$32,238
Salary	7,289
Waylon's Taxable Income	$39,527
Personal Tax Rate (15% + 6%)	23%
Tax Payable Before Credits	$ 9,091
Personal Tax Credits (Given)	(4,200)
Dividend Tax Credit [(21/29 + 32%)($4,684)]	(4,891)
Tax Payable	Nil

Amounts Received ($27,554 + $7,289)	$34,843
Personal Tax Payable	Nil
After Tax Cash Retained (Salary And Dividends)	$34,843

The comparative results for the three alternatives are as follows:

All Salary	$34,774
All Dividends	$33,750
Salary/Dividend Combination	$34,843

The combination of salary and dividends will produce the maximum after tax cash retention for Waylon. It is a $69 ($34,843 - $34,774) improvement over the all salary solution and a $1,093 ($34,843 - $33,750) improvement over the all dividend solution.

Part E - Other Factors

Other factors that might be considered include:

- The Canada employment tax credit was ignored in the calculations as it is not a credit against provincial taxes. However, it would allow the first $1,161 of salary to be received with a nil federal tax cost.
- If the effect of CPP was considered, both Waylon and Wasal Inc. would pay CPP contributions if salary was paid. Paying CPP contributions would allow him to receive CPP payments in the future, but would require both a personal and a corporate cash outflow at the present time.
- If Wasal Inc. has benefits for employees, such as a private health services plan, this could make being an employee (by taking salary) more advantageous.
- Dividend payments are not Earned Income for purposes of making RRSP contributions or deducting child care costs.
- If Waylon has a CNIL balance, dividend payments will serve to reduce this constraint on the lifetime capital gains deduction.
- Waylon should consider declaring a bonus (a form of salary) to be paid after the end of the calendar year if he does not require the cash immediately. This would defer the personal taxes without affecting corporate taxes as long as the bonus was paid within 180 days of December 31.
- Though not relevant in this problem, some provinces have payroll taxes which could be incurred.

TIF Solution Fifteen - 16

Part A - All Salary

As salary payments can be deducted by the corporation, the entire $24,200 can be paid as salary. Given this deduction, no taxes would be paid by the Company for the year. With a salary payment of $24,200, Ms. Stickle's after tax cash balance would be as follows:

Salary Payment		$24,200
Tax Before Credits [(25%)($24,200)]	($6,050)	
Personal Tax Credits (Given)	3,423	(2,627)
After Tax Cash Retained (All Salary)		$21,573

Part B - All Dividends

The tax rate for Stickle Ltd. would be 14% (38% - 10% - 17.5% + 3.5%). As dividend payments are not deductible to the Company, taxes of $3,388 [(14%)($24,200)] will have to be paid, leaving a maximum of $20,812 to be used for the payment of dividends. When this is paid, the after tax retention by Ms. Stickle will be as follows:

Non-Eligible Dividends Received	$20,812
Gross Up [(17%)($20,812)]	3,538
Taxable Dividends	$24,350
Personal Tax Rate	25%
Tax Payable Before Credits	$ 6,088
Personal Tax Credits (Given)	(3,423)
Dividend Tax Credit [(21/29 + 30%)($3,538)]	(3,623)
Tax Payable	Nil

Dividends Received	$20,812
Tax Payable	Nil
After Tax Cash Retained (All Dividends)	$20,812

Part C - Possible Improvement

While Ms. Stickle's Tax Payable is nil in Part B, subtracting personal and dividend tax credits from the tax balance gives a negative figure of $958. This means that the all dividend approach leaves unused tax credits. While not conclusive, this suggests that there may be a better solution than either all salary or all dividends.

Part D - Salary/Dividend Combination

To examine the possibility of an optimum solution using both salary and dividends, consider the result that occurs when $1,000 in salary is paid in lieu of some dividends. Because the deductible salary payment would reduce corporate taxes, dividends would only have to be decreased by $860 [($1,000)(1 - 0.14)]. The tax effects of this switch can be calculated as follows:

Increase In Salary	$1,000.00
Decrease In Dividend [($1,000)(1 - .14)]	(860.00)
Decrease In Dividend Gross Up [(17%)($860.00)]	(146.20)
Decrease In Ms. Stickle's Taxable Income	($ 6.2)
Personal Tax Rate	25%
Decrease In Tax Payable Before Dividend Tax Credit	($ 1.55)
Decrease In Dividend Tax Credit [(21/29+ 30%)($146.20)]	149.73
Net Increase In Personal Tax Payable	$ 148.18

The rate on a $1,000 increase in salary is 14.818% ($148.18 ÷ $1,000). Applying this rate to the unused credits of $958 (see Part C), gives a required increase in salary of $6,465 ($958 ÷ .14818).

Based on this payment of salary, corporate taxes and funds available for dividend payments would be calculated as follows:

Pre-Salary Corporate Taxable Income	$24,200
Salary	(6,465)
Corporate Taxable Income	$17,735
Corporate Tax [(14%)($17,735)]	(2,483)
Available For Dividends	$15,252

After tax retention at the personal level would be calculated as follows:

Non-Eligible Dividends Received	$15,252
Gross Up [(17%)($15,252)]	2,593
Taxable Dividends	$17,845
Salary	6,465
Ms. Stickle's Taxable Income	$24,310
Personal Tax Rate	25%
Tax Payable Before Credits	$ 6,078
Personal Tax Credits (Given)	(3,423)
Dividend Tax Credit [(21/29 + 30%)($2,593)]	(2,655)
Tax Payable	Nil

Amounts Received ($6,465 + $15,252)	$21,717
Personal Tax Payable	Nil
After Tax Cash Retained (Salary And Dividends)	$21,717

The comparative results for the three alternatives are as follows:

All Salary	$21,573
All Dividends	$20,812
Salary/Dividend Combination	$21,717

The combination of salary and dividends will produce the maximum after tax cash retention for Ms. Stickle. It is a $144 ($21,717 - $21,573) improvement over the all salary solution and a $905 ($21,717 - $20,812) improvement over the all dividend solution.

Part E - Other Factors

Other factors that might be considered include:

- The Canada employment tax credit was ignored in the calculations as it is not a credit against provincial taxes. However, it would allow the first $1,161 of salary to be received with a nil federal tax cost.
- If the effect of CPP was considered, both Ms. Stickle and Stickle Ltd. would pay CPP contributions if salary was paid. Paying CPP contributions would allow her to receive CPP payments in the future, but would require both a personal and a corporate cash outflow at the present time.
- If Stickle Ltd. has benefits for employees, such as a private health services plan, this could make being an employee (by taking salary) more advantageous.
- Dividend payments are not Earned Income for purposes of making RRSP contributions or deducting child care costs.

- If she has a CNIL balance, dividend payments will serve to reduce this constraint on the lifetime capital gains deduction.
- Ms. Stickle should consider declaring a bonus (a form of salary) to be paid after the end of the calendar year if she does not require the cash immediately. This would defer the personal taxes without affecting corporate taxes as long as the bonus was paid within 180 days of December 31.
- Though not relevant in this problem, some provinces have payroll taxes which could be incurred.

Chapter Sixteen Test Item File Solutions

TIF Solution Sixteen - 1

1. The owner of an existing unincorporated business will usually have assets that have been used in the business for some period of time. Because a corporation is a separate taxable entity, the transfer of these assets to a corporation will be considered a disposition for proceeds equal to their fair market value. If these fair market values exceed the tax values for the assets (adjusted cost base or UCC), the result could be capital gains and/or recapture. In the absence of ITA 85(1), the resulting tax cost could significantly discourage the transfer of unincorporated businesses to corporations.

2. As listed in the text, the entities are as follows:

- The transferor may be an **individual** who wishes to incorporate his proprietorship.
- The transferor may be a **corporation** that wishes to transfer some of its assets to a different corporation.
- The transferor may be a **trust** that wishes to transfer some of its assets to a corporation.
- The transferor may be a **partner** who wishes to incorporate his partnership interest.

3. Eligible assets are defined under ITA 85(1.1). These assets are depreciable and non-depreciable capital property, eligible capital property, resource property, and inventories other than those of real property. Items specifically excluded from this definition are:

   - inventories of real estate; and
   - real property owned by a non-resident (unless used in a business carried on in Canada).

   The basic idea behind the omission of transfers of real property inventories from the coverage of Section 85 is to prevent a real estate dealer from transferring inventories to a corporation, where they might subsequently qualify for capital gains treatment. This provision does, of course, have serious tax implications. Further, these implications are complicated by the fact that, in many situations, a transferor may be uncertain as to whether a particular real property is a capital asset and eligible for transfer at an elected value or, alternatively, an inventory item that is ineligible.

   With respect to real property owned by non-residents, ITA 2(3) indicates that non-residents will be taxed on gains resulting from the disposition of such "Taxable Canadian Property". This taxation might be avoided if the property was transferred on a tax free basis to a Canadian corporation.

4. The importance of listing all of the assets to be transferred lies in the fact that, unless a transferred asset is listed, the transfer will take place at fair market value. This can result in capital gains or recapture that will be subject to current taxation.

5. The elected transfer price is important in that it usually establishes three important values. These are:

   - The deemed proceeds of disposition for the property given up by the transferor.
   - The adjusted cost base of the consideration received by the transferor.
   - The adjusted cost base of the property transferred to the corporation.

6. Boot is a slang term for non-share consideration received by the transferor. This is typically either cash or debt. However, it could also be other financial or non-financial assets. Its significance lies in the fact that, if the amount does not exceed the elected values for the transferred assets, it can be received by the transferor on a tax free basis. Boot also serves as a floor value for amounts to be elected with respect to individual assets.

7. The **general** rules applicable to the elected value in a Section 85 rollover can be described as follows:

   Ceiling Value Fair market value of the asset transferred to the corporation.

   Floor Value The floor value will be equal to the greater of:

   - the fair market value of the non-share consideration (boot) given to the transferor in return for the assets transferred; and
   - the tax values (adjusted cost base or UCC) of the assets transferred.

8. When accounts receivable are transferred as a component of a complete business, any loss will be treated as a capital loss. This means that only one-half of the total amount is deductible. In addition, that one-half is only deductible to the extent the taxpayer has capital gains. To solve this problem, an election can be made under ITA 22 which will allow the transferor to deduct any loss on the transfer as a fully deductible business loss. As a taxpayer cannot use both ITA 22 and ITA 85, it is generally preferable to use ITA 22 and exclude any receivables from the ITA 85 election.

9. Affiliated persons are defined in the text as follows:

   A. An individual is affiliated to another individual only if that individual is his spouse or common-law partner.

   B. A corporation is affiliated with:
      1. a person who controls the corporation;
      2. each member of an affiliated group of persons who controls the corporation; and
      3. the spouse or common-law partner of a person listed in (1) or (2).

   C. Two corporations are affiliated if:
      1. each corporation is controlled by a person, and the person by whom one corporation is controlled is affiliated with the person by whom the other corporation is controlled;
      2. one corporation is controlled by a person, the other corporation is controlled by a group of persons, and each member of that group is affiliated with that person; or
      3. each corporation is controlled by a group of persons, and each member of each group is affiliated with at least one member of the other group.

   The required three examples can be selected from examples presented in this definition (e.g., an individual and his spouse).

10. The problem here is that the wording of the transfer price rules for depreciable assets requires the floor to be based on the least of the cost of each individual asset, fair market value of each individual asset, but UCC for the class as a whole. This determination has to be made with respect to each asset in the class, with the resulting figures summed for purposes of the election floor. Given this, the sum of the individual asset values may exceed the UCC for the class as a whole. When this value for the individual assets is subtracted from the balance in the class, the result will be taxable recapture. To avoid this result, ITA 85(1)(e.1) allows the assets to be transferred one at a time. When this approach is taken, the "least of" rule cannot produce recapture as, if the individual asset values exceed the class value, the class value will be subtracted.

11. When the deduction is disallowed, the transferor is deemed to continue to own the cumulative eligible capital. The positive balance in this account will continue to be subject to the usual rules related to writing off cumulative eligible capital until such time as:

- the transferee disposes of the property to a non-affiliated person (includes deemed dispositions);
- the use of the property is changed from income earning to non-income earning;
- if the transferor is a corporation,
    - it is subject to an acquisition of control; or
    - it is subject to an ITA 88(2) winding up.

12. The total adjusted cost base of the consideration received would be equal to the sum of the elected values for the assets that were transferred to the corporation. This total consideration would first be allocated to any non-share consideration in an amount equal to its fair market value (as non-share consideration is the floor for all elected values, the total elected value could not be less than the fair market value of the non-share consideration). If an amount of the total consideration remained after the allocation to non-share consideration, it would be allocated to any preferred shares to the extent of the fair market value of these shares. If a further amount remained after the preferred shares have been allocated an amount equal to their fair market value, this residual would be allocated to the common shares.

13. If the transferor had simply sold the asset for an amount in excess of the UCC value, the difference between the UCC and the capital cost would be treated as fully taxable recapture. If the transferee was allowed to treat the transferor's UCC as his capital cost, in a later sale of the property, this difference would be treated as a capital gain, only one-half of which is taxable. The requirement that the transferee retain the transferor's capital cost prevents this from happening and ensures that the transfer does not result in less taxation in the hands of the transferee.

14. In these circumstances, the capital cost for CCA purposes will be equal to the transferor's capital cost, plus one-half of any capital gain recognized by the transferor as a result of the transfer.

15. The PUC reduction is calculated by subtracting any excess of the elected value over non-share consideration from the increase in legal stated capital that resulted from the issuance of shares by the transferee.

16. The total PUC reduction is divided among the multiple classes of shares on the basis of their relative fair market values. The resulting amounts are then subtracted from the legal stated capital of each class of shares to calculate the PUC.

17. To achieve the desired goals (i.e., no current taxation combined with a maximum withdrawal of cash), he should elect to transfer the assets at their tax values. This will permit him to take out cash equal to the elected value without incurring any current taxation. If he follows this course of action, the PUC and the adjusted cost base of the new shares will be equal to nil.

18. The basic problem here is that, while the *Income Tax Act* is prepared to accept other family members sharing in the future growth of assets, it attempts to prevent any retroactive sharing of asset growth that occurred prior to the transfer of the assets under Section 85. If such retroactive gifts occur, they will generate immediate capital gains for the transferor and, in so doing, eliminate some of the tax advantages of the rollover procedure.

    To avoid this problem, it is essential that the transferor take back from the corporation an amount of consideration that is equal to the fair market value of the assets transferred. The usual type of arrangement is as follows:

- The transferor will take back non-share consideration equal to the tax values of the property transferred.
- In addition, the transferor will take back share consideration for the difference between the fair market value and the tax values of the assets transferred.

To accomplish income splitting, the share consideration taken back by the transferor will normally be preferred, or non-growth, shares. This will permit the other family members to subscribe to the common, or growth, shares, and, thereby, participate in the future growth of the assets transferred to the corporation. As the transferor will receive consideration equal to the full fair market value of the existing business, the new common shares can be issued at nominal values.

19. Mr. Lawson's plan would not be an effective method of avoiding taxation on the transfer of these assets. There are two reasons for this. First, in order to use Section 85, the assets must be transferred to a Canadian corporation, rather than a U.S. one, as suggested by Mr. Lawson. However, if he were to establish a Canadian corporation, Mr. Lawson would have to deal with his second problem. This is the fact that Section 85 does not apply to real property owned by a non-resident. In short, Mr. Lawson cannot use Section 85 in his circumstances.

20. A gifting situation can arise if the fair market value of the assets transferred to a transferee corporation exceed the fair market value of the consideration received from the transferee corporation. For the gifting rules to apply, a related party would have to have an equity interest in the transferee corporation. If this gifting situation arises, the tax consequence to the transferor would be that the amount of the gift would be added to the elected value, resulting in a need to recognize income on the transfer in the amount of the gift. For the related party, he would have an increase in his equity interest in the transferee corporation with no corresponding increase in his tax value. On a subsequent disposition of the equity interest, this additional amount would be subject to taxation.

21. An ITA 15(1) shareholder benefit will arise in a Section 85(1) rollover if the transferor takes back total consideration that has a fair market value that exceeds the fair market value of the assets that he has transferred.

22. The objective of the legislation that is contained in ITA 84.1 is to prevent an individual from removing resources from a corporation in a form that will result in a capital gain, without an arm's length disposition of his interest in the corporation. The usual goal here is for the taxpayer to make use of the lifetime capital gains deduction. In effect, when this is attempted, ITA 84.1 acts to convert certain capital gains into deemed dividends that are not eligible for the lifetime capital gains deduction.

23. The capital gains stripping rules are designed to deal with situations where a corporation is selling shares of an investee corporation. Because dividends can be received by a corporation on an essentially tax free basis, attempts will be made to structure the sale in a manner that will convert an accrued capital gain into a tax free dividend payment. ITA 55(2) serves to restrict such conversions.

TIF Solution Sixteen - 2

1. False. The transferred business can also be a corporation or a trust. In addition, the transferee corporation does not have to be a new corporation.

2. True.

3. False. Consideration can also include non-share consideration other than cash, as well as preferred shares.

4. True.

5. False. The term refers only to non-share consideration and this would exclude both preferred and common shares.

6. False.

7. True.

8. True.

9. False. The capital cost for CCA purposes will be the transferor's capital cost, plus one-half of any capital gain that results from the transfer.

10. False Any required PUC reduction will be allocated to preferred and common shares using a pro-rata allocation based on their relative fair market value.

11. True.

12. True.

13. True.

14. True.

TIF Solution Sixteen - 3

New For 2016/2017

1. D. Prepayments.

2. B. Redeemable preferred shares.

3. C. Recapture of CCA.

4. D. Mary will have to report a capital gain of $5,000 and recapture of $37,500.

5. A. $175,000.

6. B. $60,000 and Nil.

7. A. $320,000 [$360,000 - ($180,000 - $140,000)].

Retained From Previous Editions

8. B. A transferee must be a Canadian corporation.

9. A. The consideration given to the transferor must include shares of the corporation.

10. D. The assumption of transferor debt by the transferee.

11. A. A shareholder of a corporation wishes to transfer property with a fair market value of $150,000 and a cost of $100,000 to his corporation.

12. C. The fair market value of the assets transferred to the corporation.

13. B. The acquiring corporation will be able to deduct a bad debts reserve after the transfer.

14. A. $120,653. This is 4/3 of the CEC balance of $90,490.

15. C. $100,000.

16. B. Will be disallowed and allocated to the ACB of the shares in the tax records of Ali Holdings Ltd.

17. A. Will be disallowed and kept in the tax records of the transferor to be recognized when the corporation is subject to an acquisition of control or is wound up.

18. D. A taxable capital gain of $25,000, recapture of $36,000 and the capital cost of the asset to the transferee will be $125,000.

19. C. Section 85(1) does not apply. The terminal loss will be denied until the property is eventually disposed of to a non-affiliated person or the use of the property is changed to a non-income earning use.

20. A. Elected amount = $200,000 + $50,000 = $250,000
ACB = $250,000 - $200,000 - $50,000 = Nil

21. C. $200,000 ($100,000 + $100,000).

23. B. $60,000 ($150,000 - $40,000 - $50,000).

23. D. To ensure the goodwill is included in the election, and also ensure that the transfer of goodwill is not considered a gift.

24. B. $150,000; $500,000; $28,000

25. C. $105,000

26. A. $12,000. The PUC reduction will be $180,000 [$192,000 - ($20,000 - $8,000)]. This leaves a PUC of $12,000 ($192,000 - $180,000).

27. B. The property has a fair market value that exceeds the greater of the fair market value of the consideration received and the elected value.

28. A. $15,000 [$150,000 - $135,000]

29. D. Elected amount = $55,000 + [$85,000 - ($55,000 + $20,000) gift] = $65,000
ACB = $55,000 - $55,000 = Nil

30. A. The fair market value of the property transferred is less than the consideration received.

31. D. $162,500 [(300,000-200,000) + (1/2) (200,000-75,000)]

32. B. The subject corporation must be associated with the purchaser corporation. They must be connected, not associated.

33. B. An ITA 84.1(1) deemed dividend of $750,000. The PUC reduction will be $150,000, leaving the shares with a PUC of nil. Given this, the deemed dividend totals $750,000 ($150,000 + $850,000 - $100,000 - $150,000).

34. D. The corporation selling the shares must be a private company.

35. D. A taxable capital gain of $ 407,500 and a dividend of $60,000 TCG = (1/2)($950,000 - $75,000 -$60,000) = $407,500] and [safe income amount of $60,000]

TIF Solution Sixteen - 4

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

Inventories The $47,000 amount is both the floor and the ceiling, making this the only possible elected value. The transfer would result in a loss of $8,000 ($55,000 - $47,000), an amount that would be fully deductible as a business loss (ITA 23).

Land The floor would be the boot of $122,000 and the ceiling would be the fair market value of $275,000. Electing the minimum amount would result in a taxable capital gain of $19,500 [($122,000 - $83,000)(1/2)].

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

Land The ceiling would be the fair market value of $322,000 and the floor would be the boot of $160,000. Electing the minimum value of $160,000 would result in a taxable capital gain of $6,500 [(1/2)($160,000 - $147,000)].

Inventories The $23,000 amount is both the floor and the ceiling, making this the only possible elected value. Electing the minimum amount would result in a loss of $2,000 ($23,000 - $25,000). The loss would be fully deductible under ITA 23.

Exam Exercise Solution Sixteen - 3 (Elected Value For Depreciable Property)

Class 1 Property The range would be from a floor of $246,000 (the boot) to a ceiling of $390,000 (fair market value). Election of the $246,000 floor value would result in recapture of $57,000 ($191,000 - $134,000) and a taxable capital gain of $27,500 [($246,000 - $191,000)(1/2)].

Class 8 Property The range for the Class 8 asset would be from a floor of $11,000 (the boot) to a ceiling of $15,000 (fair market value). Electing the minimum value of $11,000 would result in recapture of $1,000 ($11,000 - $10,000).

Exam Exercise Solution Sixteen - 4 (Elected Value For Depreciable Property)

Class 1 Property The ceiling would be the fair market value of $263,000 and the floor would be the $122,000 UCC. The UCC should be elected for the transfer, as there will be no tax consequences. Note, however, an additional $22,000 ($122,000 - $100,000) in boot could have been received on the transfer without resulting in any tax consequences.

Class 8 Property Joan cannot use ITA 85 to transfer the Class 8 asset since it has a fair market value that is less than its UCC and is being transferred by a person (Joan) to an affiliated person (her corporation). The proceeds of disposition are deemed to be the UCC amount ($52,000), thereby disallowing the terminal loss.

The elected value should be equal to the UCC of $52,000. The transferee's capital cost is deemed to be the transferor's capital cost, with the excess of that amount over the fair market value of the asset deemed to be CCA deducted in previous periods. There will be no tax consequences as a result of the transfer.

(Not Required) If Joan created a terminal loss by electing the fair market value, it would result in a terminal loss of $6,000 ($52,000 - $46,000). Under ITA 13(21.1), this loss will be disallowed. The loss will continue to be a depreciable property owned by Joan. It will be placed in a separate class until the asset is sold by the transferee or its use is changed. Since the transferee is a corporation, Joan can also recognize the loss if the corporation is subject to an acquisition of control or is subject to an ITA 88(2) winding up.

Exam Exercise Solution Sixteen - 5 (Elected Value For CEC)

The range of values would be a ceiling of $168,000 (fair market value) and a floor of $121,000 (non-share consideration).

If the minimum value of $121,000 is elected, the relevant calculations are as follows:

Initial Balance [(3/4)($121,000]	$90,750
2014 CEC [(7%)($90,750)]	(6,353)
Balance January 1, 2015	$84,397
3/4 Of Boot [(3/4)($121,000)]	(90,750)
Balance After Rollover	($ 6,353)

As this negative amount is equal to the $6,353 that was deducted in the previous year, the full amount must be included in 2015 income.

Exam Exercise Solution Sixteen - 6 (Elected Value For CEC)

The ceiling for the election would be the fair market value of $220,000, and the floor would be the non-share consideration of $200,000.

The CEC deductions for 2013 and 2014 would be calculated as follows:

	CEC Balance	CEC Deductions
Opening Balance [(3/4)($200,000)]	$150,000	
2013 CEC [(7%)($150,000)]	(10,500)	$10,500
Balance January 1, 2014	$139,500	
2014 CEC [(7%)($139,500)]	(9,765)	9,765
Balance January 1, 2015	$129,735	
3/4 Of Boot [(3/4)($200,000)]	(150,000)	
Balance After Rollover	($ 20,265)	$20,265

As this negative balance is equal to the total amount of CEC deducted in 2013 and 2014, this amount will have to be included in income in 2015.

Exam Exercise Solution Sixteen - 7 (ACB Of Consideration Received)

The adjusted cost base amounts would be calculated as follows:

Elected Value	$86,800
ACB Of Note (Fair Market Value)	(71,400)
ACB Of All Shares	$15,400
ACB Of Preferred Shares*	(15,400)
ACB Of Common Shares (Residual)	Nil

*Remainder available as it is less than the fair market value of $74,200.

Exam Exercise Solution Sixteen - 8 (ACB Of Consideration Received)

The adjusted cost base amounts would be calculated as follows:

Elected Value	$220,000
ACB Of Note (Fair Market Value)	(110,000)
ACB Of All Shares	$110,000
ACB Of Preferred Shares (Fair Market Value)	(90,000)
ACB Of Common Shares (Residual)	$ 20,000

Exam Exercise Solution Sixteen - 9 (PUC Reduction - Section 85)

The adjusted cost base amounts would be calculated as follows:

Elected Value	$91,200
ACB Of Note (Fair Market Value)	(66,400)
Available For Shares	$24,800
ACB Of Preferred Shares*	(24,800)
ACB Of Common Shares (Residual)	Nil

*Remainder available as it is less than the fair market value of $77,600.

The total PUC reduction would be calculated as follows:

Increase In Legal Stated Capital ($77,600 + $43,200)		$120,800
Less The Excess Of:		
Total Elected Value	($91,200)	
Over The Non-Share Consideration	66,400	(24,800)
PUC Reduction		$ 96,000

Note that this reduction is equal to the deferred gain on the election of $96,000 ($187,200 - $91,200). The PUC reduction would be allocated on the basis of fair market values as follows:

Preferred Stock [($96,000)($77,600 ÷ $120,800)]	$61,669
Common Stock [($96,000)($43,200 ÷ $120,800)]	34,331
Total PUC Reduction	$96,000

Subsequent to applying this reduction, the remaining PUC of the two classes of shares would be as follows:

	Preferred Stock	Common Stock
Legal Stated Capital	$77,600	$43,200
PUC Reduction (From Preceding)	(61,669)	(34,331)
Total PUC	$15,931	$ 8,869

Note that the sum of these two figures equals $24,800 ($15,931 + $8,869), the total adjusted cost base of the preferred and common shares, as well as the difference between the elected value of $91,200 and the total non-share consideration of $66,400.

Exam Exercise Solution Sixteen - 10 (PUC Reduction - Section 85)

The adjusted cost base amounts would be calculated as follows:

Elected Value	$111,000
ACB Of Cash	(21,000)
Available For Shares	$ 90,000
ACB Of Preferred Shares (Fair Market Value)	(50,000)
ACB Of Common Shares (Residual)	$ 40,000

The total PUC reduction would be calculated as follows:

Increase In Legal Stated Capital ($50,000 + $271,000)		$321,000
Less The Excess Of:		
Total Elected Value	($111,000)	
Over The Non-Share Consideration	21,000	(90,000)
PUC Reduction		$231,000

Note that this reduction is equal to the deferred gain on the election of $321,000 ($342,000 - $111,000). The PUC reduction would be allocated on the basis of fair market values as follows:

Preferred Stock [($231,000)($50,000 ÷ $321,000)]	$ 35,981
Common Stock [($231,000)($271,000 ÷ $321,000)]	195,019
Total PUC Reduction	$231,000

Subsequent to applying this reduction, the remaining PUC of the two classes of shares would be as follows:

	Preferred Stock	Common Stock
Legal Stated Capital	$50,000	$271,000
PUC Reduction (From Preceding)	(35,981)	(195,019)
Total PUC	$14,019	$ 75,981

Note that the sum of these two figures equals $90,000 ($14,019 + $75,981), the total adjusted cost base of the preferred and common shares, as well as the difference between the elected value of $111,000 and the total non-share consideration of $21,000.

Exam Exercise Solution Sixteen - 11 (Transfers Under Section 85 - Tax Consequences)

The tax consequences to Mr. Wild and the corporation can be described as follows:

- Mr. Wild will have a taxable capital gain of $20,000 [(1/2)($160,000 - $120,000)].
- Mr. Wild will have recapture of CCA of $22,000 ($120,000 - $98,000).
- Mr. Wild will be holding shares with an adjusted cost base of nil (elected value of $160,000, less non-share consideration of $160,000). The PUC of the shares would also be nil (legal stated capital of $20,000, less a PUC reduction of $20,000).
- The corporation will have a depreciable asset with a capital cost of $160,000 and a deemed capital cost for CCA and recapture purposes, of $140,000 [$120,000 + (1/2)($160,000 - $120,000)].

Exam Exercise Solution Sixteen - 12
(Transfers Under Section 85 - Tax Consequences)

Part 1 The adjusted cost base of all of the consideration will total the elected value of $375,000. It will be allocated as follows:

Elected Value	$375,000
Non-Share Consideration ($115,000 + $85,000)	(200,000)
Adjusted Cost Base Of All Shares	$175,000
Adjusted Cost Base Of Preferred Shares (FMV)	(100,000)
Adjusted Cost Base Of Common Shares (Residual)	$ 75,000

Part 2 The PUC of the shares issued must be reduced as follows:

Increase In Legal Stated Capital ($100,000 + $1,210,000)		$1,310,000
Less The Excess Of:		
Elected Value	($375,000)	
Over The Non-Share Consideration	200,000	(175,000)
PUC Reduction		$1,135,000

This PUC reduction would be split between the preferred and common shares on the basis of their fair market values:

Preferred Stock [($100,000/$1,310,000)($1,135,000)]	$ 86,641
Common Stock [($1,210,000/$1,310,000)($1,135,000)]	1,048,359
Total PUC Reduction	$1,135,000

Subsequent to applying this reduction, the remaining PUC of the two classes of shares would be as follows:

	Preferred Stock	Common Stock
Legal Stated Capital	$100,000	$1,210,000
PUC Reduction (From Preceding)	(86,641)	(1,048,359)
Total PUC	$ 13,359	$ 161,641

Part 3 The tax consequences of the preferred stock redemption would be as follows:

Proceeds Of Redemption	$100,000
PUC Of The Preferred Shares	(13,359)
ITA 84(3) Deemed Dividend (Non-Eligible)	$ 86,641

Proceeds Of Redemption	$100,000
ITA 84(3) Deemed Di	($ 86,641)
Inclusion Rate	1/2
Allowable Capital Loss	($ 43,321)

The grossed up non-eligible dividend of $102,236 [(118%)($86,641)] would qualify for a federal dividend tax credit of $11,263 [(13/18)(18%)($86,641)]. The allowable capital loss is only deductible against taxable capital gains.

Exam Exercise Solution Sixteen - 13 (Gift To Related Party - Section 85)

As Mr. Rosen transferred property with a post-reassessment fair market value of $100,000 and received consideration with a fair market value of $87,750 ($67,500 + $20,250), he has made a gift to his daughter of $12,250 ($100,000 - $87,750). The tax consequences for Mr. Rosen and his daughter are as follows:

Deemed Elected Value = Deemed Proceeds Of Disposition ($67,500 + $12,250)	$79,750
Adjusted Cost Base	(67,500)
Capital Gain	$12,250
Inclusion Rate	1/2
Taxable Capital Gain	$ 6,125

Elected Value (Original)	$67,500
Non-Share Consideration	(67,500)
Adjusted Cost Base Of Preferred Shares	Nil

The required PUC reduction and resulting PUC would be calculated as follows:

Increase In Legal Stated Capital		$20,250
Less Excess Of:		
Deemed Elected Value	($79,750)	
Over Non-Share Consideration	67,500	(12,250)
PUC Reduction		$ 8,000
PUC Of Preferred Shares ($20,250 - $8,000)		$12,250

The fair market value of the common shares is $12,750 ($100,000 + $500 - $67,500 - $20,250).

The sale of the shares for their fair market value would result in the following:

	Preferred	Common
Proceeds (Fair Market Value)	$20,250	$12,750
Adjusted Cost Base	Nil	(500)
Capital Gain	$20,250	$12,250
Inclusion Rate	1/2	1/2
Taxable Capital Gain	$10,125	$ 6,125

If the property had simply been sold for its $100,000 post-reassessment fair market value, there would have been a $16,250 [(1/2)($$100,000 - $67,500)] taxable capital gain. In the procedures that were used, there is a $6,125 taxable capital gain on the ITA 85(1) transfer, along with a $10,125 taxable capital gain on the sale of the preferred shares. This is the same $16,250 amount that would have occurred on the direct sale of the non-depreciable capital property.

Unfortunately, because the common shares have increased in value by the amount of the gift with no corresponding increase in the adjusted cost base, there is an additional $6,125 taxable capital gain (one-half the amount of the gift) on the sale of the daughter's common shares.

Exam Exercise Solution Sixteen - 14 (Gift To Related Party - Section 85)

As Mr. Blunt transferred property with a post-reassessment fair market value of $475,000 and received consideration with a fair market value of $400,000 ($150,000 + $250,000), he has made a gift to his daughter of $75,000 ($475,000 - $400,000). The tax consequences for Mr. Blunt and his daughter are as follows:

Deemed Elected Value = Deemed Proceeds Of Disposition ($250,000 + $75,000)	$325,000
Adjusted Cost Base	(250,000)
Capital Gain	$ 75,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 37,500

Elected Value (Original)	$250,000
Non-Share Consideration	(250,000)
Adjusted Cost Base Of Preferred Shares	Nil

The required PUC reduction and resulting PUC would be calculated as follows:

Increase In Legal Stated Capital		$150,000
Less Excess Of:		
Deemed Elected Value	($325,000)	
Over Non-Share Consideration	250,000	(75,000)
PUC Reduction		$ 75,000

PUC Of Preferred Shares ($150,000 - $75,000)	$75,000

The fair market value of the common shares is $75,100 ($475,000 + $100 - $250,000 - $150,000).

The sale of the shares for their fair market value would result in the following:

	Preferred	Common
Proceeds (Fair Market Value)	$150,000	$75,100
Adjusted Cost Base	Nil	(100)
Capital Gain	$150,000	$75,000
Inclusion Rate	1/2	1/2
Taxable Capital Gain	$ 75,000	$37,500

If the property had simply been sold for its post-reassessment fair market value of $475,000, there would have been a $112,500 [(1/2)($$475,000 - $250,000)] taxable capital gain. In the procedures that were used, there is a $37,500 taxable capital gain on the ITA 85(1) transfer, along with a $75,000 taxable capital gain on the sale of the preferred shares. This is the same $112,500 amount that would have occurred on the direct sale of the non-depreciable capital property.

Unfortunately, because the common shares have increased in value by the amount of the gift with no corresponding increase in the adjusted cost base, there is an additional $37,500 taxable capital gain (one-half the amount of the gift) on the sale of the daughter's common shares.

Exam Exercise Solution Sixteen - 15 (Benefit To Transferor - Section 85)

By electing to transfer at the fair market value of $224,000, Mrs. Keanings will have a taxable capital gain of $44,000 [(1/2)($224,000 - $136,000)].

There is an ITA 15(1) shareholder benefit calculated as follows:

Fair Market Value Of Total Consideration ($193,000 + $90,000)	$283,000
Fair Market Value Of Property	(224,000)
ITA 15(1) Shareholder Benefit	$ 59,000

The total effect on Net Income For Tax Purposes is as follows:

Taxable Capital Gain	$ 44,000
Shareholder Benefit	59,000
Total Addition To Net Income For Tax Purposes	$103,000

The ITA 15(1) benefit of $59,000 would be added to the adjusted cost base of the preferred shares, resulting in the following adjusted cost base:

Elected Value	$224,000
ACB Of Note (Fair Market Value)	(193,000)
Available For Shares	$ 31,000
ITA 15(1) Shareholder Benefit	59,000
ACB Of Preferred Shares	$ 90,000

There will be a PUC reduction calculated as follows:

Increase In Legal Stated Capital		$90,000
Less Excess, If Any, Of:		
Total Elected Value	($224,000)	
Over The Non-Share Consideration	193,000	(31,000)
ITA 85(2.1) PUC Reduction		$59,000

This will leave a PUC of $31,000 ($90,000 - $59,000). As this is equal to the $31,000 ($224,000 - $193,000) increase in net assets, there is no ITA 84(1) deemed dividend.

Exam Exercise Solution Sixteen - 16 (Benefit To Transferor - Section 85)

By electing to transfer at the fair market value of $415,000, Ms. Stuart will have a taxable capital gain of $72,500 [(1/2)($415,000 - $270,000)].

There is also an ITA 15(1) shareholder benefit calculated as follows:

Fair Market Value Of Total Consideration ($380,000 + $170,000)	$550,000
Fair Market Value Of Property	(415,000)
ITA 15(1) Shareholder Benefit	$135,000

The total effect on Net Income For Tax Purposes is as follows:

Taxable Capital Gain	$ 72,500
Shareholder Benefit	135,000
Total Addition To Net Income For Tax Purposes	$207,500

The ITA 15(1) benefit of $135,000 would be added to the adjusted cost base of the preferred shares, resulting in the following adjusted cost base:

Elected Value	$415,000
ACB Of Note (Fair Market Value)	(380,000)
Available For Shares	$ 35,000
ITA 15(1) Shareholder Benefit	135,000
ACB Of Preferred Shares	$170,000

There will be a PUC reduction calculated as follows:

Increase In Legal Stated Capital		$170,000
Less Excess, If Any, Of:		
Total Elected Value	($415,000)	
Over The Non-Share Consideration	380,000	(35,000)
ITA 85(2.1) PUC Reduction		$135,000

This will leave a PUC of $35,000 ($170,000 - $135,000). As this is equal to the $35,000 ($415,000 - $380,000) increase in net assets, there is no ITA 84(1) deemed dividend.

Exam Exercise Solution Sixteen - 17 (Dividend Stripping)

Mr. Stack (an individual) has sold shares of a subject corporation to a purchasing corporation, both corporations do not deal with Mr. Stack at arm's length, and the two corporations are connected subsequent to the sale. As a consequence, ITA 84.1 is applicable. Given this, the tax consequences of this transaction to Mr. Stack are as follows:

Increase In Legal Stated Capital		$309,000
Less Excess, If Any, Of:		
PUC And ACB Of Subject Shares	($132,000)	
Over The Non-Share Consideration	390,000	Nil
PUC Reduction		$309,000
PUC Of New Shares ($309,000 - $309,000)		Nil
Increase In Legal Stated Capital		$309,000
Non-Share Consideration		390,000
Total		$699,000
Less The Sum Of:		
PUC And ACB Of Subject Shares	($132,000)	
PUC Reduction	(309,000)	(441,000)
ITA 84.1 Deemed Dividend (Non-Eligible)		$258,000
Elected Proceeds Of Disposition For Subject Shares		$699,000
ITA 84.1 Deemed Dividend		(258,000)
Proceeds For Capital Gains Purposes		$441,000
ACB Of Subject Shares		(132,000)
Capital Gain		$309,000
Inclusion Rate		1/2
Taxable Capital Gain		$154,500
ACB Of New Shares ($699,000 - $390,000)		$309,000

The grossed up non-eligible dividend of $304,440 [(118%)($258,000)] would qualify for a federal dividend tax credit of $33,540 [(13/18)(18%)($258,000)]. In addition, there would be a taxable capital gain of $154,500 that would be eligible for the lifetime capital gains deduction. If Mr. Stack claims the deduction, he may need to pay alternative minimum tax.

Exam Exercise Solution Sixteen - 18 (Capital Gains Stripping)

The redemption of the preferred shares received from Sored Company would result in an ITA 84(3) deemed dividend calculated as follows:

Proceeds Of Redemption	$940,000
PUC Of Redeemed Shares	(125,000)
ITA 84(3) Deemed Dividend	$815,000

As this is an intercorporate dividend, it would normally be deducted in calculating the Taxable Income of Foral Inc.

However, a dividend has been received in conjunction with a disposition of shares to an arm's length party. In addition, it would appear that one of the purposes of the dividend was to reduce the capital gain that would normally have resulted from the disposition of the shares. This indicates that ITA 55(2) would be applicable, resulting in the following tax consequences:

ITA 84(3) Deemed Dividend	$815,000
Amount Deemed Not To Be A Dividend Under ITA 55(2)(a) [$815,000 - (80%)($285,000)]	(587,000)
ITA 84(3) Deemed Dividend After Adjustment	$228,000

Proceeds Of Redemption Before Adjustment	$940,000
ITA 84(3) Deemed Dividend After Adjustment	(228,000)
Adjusted Redemption Proceeds	$712,000
Adjusted Cost Base	(125,000)
Capital Gain	$587,000
Inclusion Rate	1/2
Taxable Capital Gain	$293,500

There would be a tax free dividend of the safe income of $228,000 [(80%)($285,000)] and a taxable capital gain of $293,500.

TIF Solution Sixteen - 5A

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

A. 10

B. 6

C. 7

D. 2

E. 1

F. 8

G. 5

H. 9

The two unused definitions are as follows:

Terminal Loss = 4

Transferor = 3

TIF Solution Sixteen - 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. 13 (not 2)

B. 8 (not 14)

C. 10

D. 3

E. 1 (not 9)

F. 11 (not 5)

G. 7

H. 12

The two unused definitions are as follows:

Terminal Loss = 6

Transferor = 4

TIF Solution Sixteen - 6

Part A - Transfer Under ITA 85(1)

As the $807,000 elected value was equal to the tax value of the property, there would be no tax consequences associated with the rollover. The tax consequences of selling the common stock would be calculated as follows:

Total Elected Value	$ 807,000
Non-Share Consideration	Nil
Adjusted Cost Base - Common Stock (Residual)	$ 807,000

Proceeds Of Disposition	$1,200,000
Adjusted Cost Base - Common Stock	(807,000)
Capital Gain	$ 393,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 196,500

Part B - Comparison To Direct Sale

The tax consequences of selling the property directly would be as follows:

	Land	Building
Proceeds Of Disposition	$300,000	$900,000
Adjusted Cost Base/Capital Cost	(225,000)	(725,000)
Capital Gain	$ 75,000	$175,000
Inclusion Rate	1/2	1/2
Taxable Capital Gain	$ 37,500	$ 87,500

Based on these calculations, the overall tax effect of the direct sale would be as follows:

Taxable Capital Gain On Land	$ 37,500
Taxable Capital Gain on Building	87,500
Recapture On Building ($725,000 - $582,000)	143,000
Total Tax Effect	$268,000

The reason for the difference lies in the type of income that the two approaches produce. The total amount of income, before consideration of preferential treatment, that you would expect on this transaction is $393,000 ($1,200,000 - $807,000). When ITA 85(1) is used, this full amount is received as a capital gain, resulting in an income inclusion of $196,500. In contrast, with the direct sale, only $250,000 ($75,000 + $175,000) of the total income is received as a capital gain, with the remaining $143,000 ($393,000 - $250,000) being received as fully taxable recapture. The result is a higher amount included in income under the direct sale alternative.

There is nothing illegal about this result. However, the CRA might view this situation as an avoidance transaction and attempt to apply GAAR to these results.

TIF Solution Sixteen - 7

Part A - Adjusted Cost Base Of Consideration

The adjusted cost base for each item of consideration, under the three alternatives, would be calculated as follows:

	Alternative		
	One	Two	Three
Elected Transfer Price	$225,000	$225,000	$225,000
ACB - Boot	(150,000)	(175,000)	(210,000)
Available For Preferred And Common Stock	$75,000	$ 50,000	$ 15,000
ACB - Preferred Stock	(50,000)	(50,000)	N/A
ACB - Common Stock (Residual)	$ 25,000	N/A	$ 15,000

Part B - Legal Stated Capital And PUC

The legal stated capital for the two classes of shares would be as follows:

	Alternative		
	One	Two	Three
Preferred Stock	$ 50,000	$450,000	Nil
Common Stock	425,000	Nil	$415,000
Total Legal Stated Capital	$475,000	$450,000	$415,000

The required PUC reduction would be calculated as follows:

	Alternative		
	One	Two	Three
Increase In Legal Stated Capital - All Shares (A)	$475,000	$450,000	$415,000
Elected Amount	$225,000	$225,000	$225,000
Non-Share Consideration	(150,000)	(175,000)	(210,000)
Elected Amount, Less Boot (B)	$ 75,000	$ 50,000	$ 15,000
Required PUC Reduction (A - B)	$400,000	$400,000	$400,000

Alternative One In Alternative One, the PUC reduction would have to be split between the two classes of shares on the basis of their relative fair market values. The relevant calculation would be as follows:

Preferred Shares: [($400,000)($50,000 ÷ $475,000)] = $42,105

Common Shares: [($400,000)($425,000 ÷ $475,000)] = $357,895

This would leave a PUC of $7,895 for the preferred shares ($50,000 - $42,105), and a PUC of $67,105 for the common shares ($425,000 - $357,895).

Alternative Two In Alternative Two, the entire PUC reduction of $400,000 would be allocated to the preferred shares, leaving a PUC of $50,000 ($450,000 - $400,000).

Alternative Three In Alternative Three, the entire PUC reduction of $400,000 would be allocated to the common stock, leaving a PUC of $15,000 ($415,000 - $400,000).

TIF Solution Sixteen - 8

Part A - Adjusted Cost Base Of Consideration

The adjusted cost base for each item of consideration, under the three alternatives, would be calculated as follows:

	Alternative		
	One	Two	Three
Elected Transfer Price	$400,000	$400,000	$400,000
ACB - Boot	(150,000)	(375,000)	(300,000)
Available For Preferred And Common Stock	$250,000	$ 25,000	$100,000
ACB - Preferred Stock	(150,000)	(25,000)	N/A
ACB - Common Stock (Residual)	$100,000	N/A	$100,000

Part B - Legal Stated Capital And PUC

The legal stated capital for the two classes of shares would be as follows:

	Alternative		
	One	Two	Three
Preferred Stock	$150,000	$300,000	Nil
Common Stock	375,000	Nil	$375,000
Total Legal Stated Capital	$525,000	$300,000	$375,000

The required PUC reduction would be calculated as follows:

	Alternative		
	One	Two	Three
Increase In Legal Stated Capital - All Shares (A)	$525,000	$300,000	$375,000
Elected Amount	$400,000	$400,000	$400,000
Non-Share Consideration	(150,000)	(375,000)	(300,000)
Elected Amount, Less Boot (B)	$250,000	$ 25,000	$100,000
Required PUC Reduction (A - B)	$275,000	$275,000	$275,000

Alternative One In Alternative One, the PUC reduction would have to be split between the two classes of shares on the basis of their relative fair market values. The relevant calculation would be as follows:

Preferred Shares: [($275,000)($150,000 ÷ $525,000)] = $78,571

Common Shares: [($275,000)($375,000 ÷ $525,000)] = $196,429

This would leave a PUC of $71,429 ($150,000 - $78,571) for the preferred shares, and a PUC of $178,571 ($375,000 - $196,429) for the common shares.

Alternative Two In Alternative Two, the entire PUC reduction of $275,000 would be allocated to the preferred shares, leaving a PUC of $25,000 ($300,000 - $275,000).

Alternative Three In Alternative Three, the entire PUC reduction of $275,000 would be allocated to the common stock, leaving a PUC of $100,000 ($375,000 - $275,000).

TIF Solution Sixteen - 9

Case A

Immediate Tax Consequences As the elected values for the land and building are equal to their tax costs, there are no immediate tax consequences resulting from the transfer.

Tax Cost Of The Land And Building The tax cost of the land (adjusted cost base) would be the elected value of $280,000. The tax cost of the building (UCC) would be the elected value of $391,000. Note, however, the new corporation would retain the old capital cost of $500,000, with the $109,000 difference being treated as deemed CCA.

ACB Of Shares The ACB of the shares issued by the corporation would be calculated as follows:

Elected Value ($280,000 + $391,000)	$671,000
Fair Market Value Of Non-Share Consideration	Nil
ACB Of Shares	$671,000

PUC Of Shares The required PUC reduction and resulting PUC would be calculated as follows:

Legal Stated Capital Of Shares		$1,200,000
Less Excess, If Any, Of:		
Elected Value	($671,000)	
Over The Non-Share Consideration	Nil	(671,000)
PUC Reduction		$ 529,000
PUC Of Shares ($1,200,000 - $529,000)		$ 671,000

Case B

Immediate Tax Consequences As the elected value for the land of $425,000 exceeds the $280,000 adjusted cost base of the land, there is a taxable capital gain of $72,500 [(1/2)($425,000 - $280,000)]. As the elected value of the building is equal to its tax cost, there are no immediate tax consequences associated with the transfer of the building.

Tax Cost Of The Land And Building The tax cost of the land (adjusted cost base) would be the elected value of $425,000. The tax cost of the building (UCC) would be the elected value of $391,000. Once again, the new corporation would retain the old capital cost of $500,000, with the $109,000 difference being treated as deemed CCA.

ACB Of Shares The ACB of the shares issued by the corporation would be calculated as follows:

Elected Value ($425,000 + $391,000)	$816,000
Fair Market Value Of Non-Share Consideration	Nil
ACB Of Shares	$816,000

PUC Of Shares The required PUC reduction and resulting PUC would be calculated as follows:

Legal Stated Capital Of Shares		$1,200,000
Less Excess, If Any, Of:		
Elected Value	($816,000)	
Over The Non-Share Consideration	Nil	(816,000)
PUC Reduction		$ 384,000
PUC Of Shares ($1,200,000 - $384,000)		$ 816,000

Case C

Immediate Tax Consequences As the elected value for the land of $425,000 exceeds the $280,000 adjusted cost base of the land, there is a taxable capital gain of $72,500 [(1/2)($425,000 - $280,000)]. As the elected value of the building is equal to its tax cost, there are no immediate tax consequences associated with the transfer of the building.

Tax Costs Of The Land And Building The tax cost of the land (adjusted cost base) would be the elected value of $425,000. The tax cost of the building (UCC) would be the elected value of $391,000. Note, however, that the new corporation would retain the old capital cost of $500,000, with the $109,000 difference being treated as deemed CCA.

ACB Of Shares The ACB of the shares issued by the corporation would be calculated as follows:

Elected Value ($425,000 + $391,000)	$816,000
Fair Market Value Of Non-Share Consideration	(816,000)
ACB Of Shares	Nil

PUC Of Shares The required PUC reduction and resulting PUC would be calculated as follows:

Legal Stated Capital Of Shares		$384,000
Less Excess, If Any, Of:		
Elected Value	($816,000)	
Over The Non-Share Consideration	816,000	Nil
PUC Reduction		$384,000
PUC Of Shares ($384,000 - $384,000)		Nil

TIF Solution Sixteen - 10

Income Generated By The Transfer

This transaction will affect Mr. Notion's current year income as follows:

UCC For Class	$52,000
Dispositions - Lesser Of:	
• Capital Cost = $58,000	
• Proceeds Of Disposition (Elected Value) = $78,000	(58,000)
Negative Balance	($ 6,000)
Recapture Of CCA	6,000
UCC	Nil

Proceeds Of Disposition (Elected Value)	$78,000
Capital Cost Of Property	(58,000)
Capital Gain	$20,000
Inclusion Rate	1/2
Taxable Capital Gain	$10,000
Allowable Capital Loss On Other Property [(1/2)($20,000)]	(10,000)
Net Taxable Capital Gain	Nil

Mr. Norton will have business income of $6,000, the recapture of CCA. His net taxable capital gain is nil.

Adjusted Cost Base Of Consideration

The adjusted cost base of the consideration received by Mr. Notion would be as follows:

Total Elected Value	$78,000
Adjusted Cost Base Of Boot (Fair Market Value)	(68,000)
Available For Share Consideration	$10,000
Adjusted Cost Base Of Preferred Stock	(10,000)
Adjusted Cost Base Of The Common Stock (Residual)	Nil

Capital Cost Of Transferred Property

The capital cost, for CCA and recapture purposes, would be calculated as follows:

Capital Cost To Transferor		$58,000
Proceeds Of Disposition To Transferor	$78,000	
Capital Cost - Property Transferred	(58,000)	
Excess	$20,000	
Fraction	1/2	10,000
Capital Cost For CCA Purposes		$68,000

The adjusted cost base of the property for capital gains purposes is the elected value of $78,000.

Paid Up Capital

The total PUC for the two classes of shares would be calculated as follows:

Increase In Legal Stated Capital ($20,000 + $4,000)		$24,000
Less Excess Of:		
Elected Amount	($78,000)	
Over The Non-Share Consideration	68,000	(10,000)
Reduction In PUC		$14,000

The PUC reduction would be allocated on the basis of fair market values as follows:

Preferred Stock [($14,000)($20,000 ÷ $24,000)]	$11,667
Common Stock [($14,000)($4,000 ÷ $24,000)]	2,333
Total PUC Reduction	$14,000

Subsequent to applying this reduction, the remaining PUC of the two classes of shares would be as follows:

	Preferred Stock	Common Stock
Legal Stated Capital	$20,000	$4,000
PUC Reduction (From Preceding)	(11,667)	(2,333)
Total PUC	$ 8,333	$1,667

TIF Solution Sixteen - 11

Part A - Tax Consequences Of Transfer

With respect to the land, the $220,000 elected value will be both the proceeds of disposition to Ms. Bond and the adjusted cost base to the corporation. As the elected value is equal to Ms. Bond's adjusted cost base, there will be no tax consequences resulting from the transfer.

The elected value and proceeds of disposition for the building is its original cost, an amount that is in excess of its UCC. This will result in Ms. Bond having to report recapture of $105,000 ($730,000 - $625,000). However, with the elected value at Ms. Bond's original cost for the building, both the capital cost and the UCC will be the elected value of $730,000.

Part B - Adjusted Cost Base Of The Consideration

The adjusted cost base of all consideration received by Ms. Bond will be the total elected value of $950,000. It will be allocated as follow:

Total Elected Value	$950,000
Total Non-Share Consideration	
($400,000 Old Debt + $500,000 New Debt)	(900,000)
Adjusted Cost Base Of Common Shares	$ 50,000

Part C - PUC Of The New Shares

The calculation of PUC would be as follows:

Increase In Legal Stated Capital (Fair Market Value)		$590,000
Less Excess Of:		
Elected Amount	($950,000)	
Over The Total Non-Share Consideration	900,000	(50,000)
Reduction In PUC		$540,000

The PUC of the common shares would be reduced to $50,000 ($590,000 - $540,000).

Part D - Sale Of Common Shares

The increase in Net Income For Tax Purposes from a sale of the shares for $650,000 would be as follows:

Proceeds Of Disposition	$650,000
Adjusted Cost Base	(50,000)
Capital Gain	$600,000
Inclusion Rate	1/2
Taxable Capital Gain	$300,000

As Taxable Income consequences are not required, the effect of the lifetime capital gains deduction has not been considered.

Part E - Tax Consequences Of Redemption

The tax consequences of a redemption for $650,000 would be as follows:

Proceeds From Redemption	$650,000
PUC	(50,000)
ITA 84(3) Deemed Dividend (Non-Eligible)	$600,000

There would be no capital gain on this redemption as shown in the following calculation:

Redemption Proceeds	$650,000
ITA 84(3) Deemed Dividend	(600,000)
Deemed Proceeds Of Disposition	$ 50,000
Adjusted Cost Base	(50,000)
Capital Gain	Nil

The amount to be included in Net Income For Tax Purposes would be $702,000, the $600,000 deemed non-eligible dividend grossed up by 17 percent.

There would also be a federal dividend tax credit of $73,862 [(21/29)(17%)($600,000)].

TIF Solution Sixteen - 12

Part A - Assets To Be Transferred And Their Elected Values

Of the assets in Mr. Danforth's Balance Sheet accounts, Cash and Prepayments are not among the eligible assets listed in ITA 85(1.1). This is of no consequence as the tax value of these assets is generally equal to their carrying values.

The fair market value of the Accounts Receivable is $1,250 ($13,750 - $12,500) less than their face value, reflecting Mr. Danforth's estimate of accounts that will not be collected. While these Accounts Receivable could be transferred under Section 85, they are usually transferred under the provisions of ITA 22. ITA 22 is used for two reasons. First, it means that the $1,250 loss on the transfer will be a fully deductible business loss, rather than a capital loss that will be disallowed on a transfer to a corporation controlled by the transferor. In addition, the use of the ITA 22 joint election will permit the transferee corporation to deduct actual bad debts as they occur as business expenses, rather than as capital losses.

With respect to Inventories, their fair market value and their carrying value are equal. Given this, there is no reason to transfer them under the provisions of Section 85 and they should be sold to Danforth Inc. for their fair market value.

With respect to the Land, there is an unrealized capital loss which will be disallowed on a transfer to an affiliated person. This is the case, without regard to whether Mr. Danforth makes the transfer directly or under the provisions of ITA 85(1). Given this, there is no reason to use ITA 85(1) for this transfer and it should be sold to Danforth Inc. for its fair market value.

There is a potential terminal loss on the transfer of the equipment. Given this, ITA 13(21.2) prevents the use of ITA 85(1) for the transfer. In addition, ITA 13(21.2) disallows the loss on any transfer to an affiliated person. This problem can be avoided if Mr. Danforth sells the equipment to a non-affiliated person. However, if the business requires the equipment, he will have to sell it to the corporation and he will not be able to make immediate use of the terminal loss at the time of the transfer.

If we assume that Mr. Danforth chooses to make the ITA 22 election, the following assets will not be transferred under the provisions of ITA 85(1):

Cash (Not Eligible)	$ 2,500
Accounts Receivable (ITA 22 Election Used)	12,500
Inventories (Cost = FMV)	17,500
Prepayments (Cost = FMV)	7,500
Land (Disallowed Capital Loss)	77,500
Equipment (Cannot Use Section 85)	7,500
Total	$125,000

In order to minimize capital gains arising on the transfer of proprietorship assets and liabilities to the corporation, the elected price should be the lower of the tax value or the fair market value. The appropriate elected values for the assets that will be transferred using ITA 85 are indicated in the schedule that follows:

	Tax Values	Fair Market Value	Elected Value
Temporary Investments	$ 27,500	$ 37,500	$27,500
Buildings	70,000	125,000	70,000
Goodwill (See Note)	Nil	117,500	1
Total Assets Transferred	$97,500	$280,000	$97,501

Note It is prudent to add at least a nominal elected value for goodwill. A failure to do so could result in the application of ITA 69, with the transfer assessed to the transferor at fair market value.

Part B - Maximum Non-Share Consideration

The liabilities that are assumed by the corporation are considered to be a part of the non-share consideration that is received by the transferor. The maximum amount of non-share consideration that can be received by Mr. Danforth on a tax free basis is $97,501. The non-share consideration would be made up of the corporation's assumption of the proprietorship's liabilities of $20,000, plus debt issued by the new corporation in the amount of $77,501.

Part C - Capital Gain On Sale Of Shares

The adjusted cost base of the shares would be nil, as per the following calculation:

Elected Value	$97,501
Non-Share Consideration Received	97,501
Adjusted Cost Base Of Shares	Nil

Given this, the taxable capital gain on the sale of the shares would be calculated as follows:

Proceeds Of Disposition	$208,000
Adjusted Cost Base Of Shares	Nil
Capital Gain	$208,000
Inclusion Rate	1/2
Taxable Capital Gain	$104,000

Since Danforth Inc. is a qualified small business corporation and Mr. Danforth has no CNIL, the taxable capital gain arising on the disposition of its shares would be eligible for the lifetime capital gains deduction. This means that he will be able to deduct an amount equal to the entire taxable capital gain in calculating his Taxable Income. However, use of his lifetime capital gains deduction to eliminate the taxable capital gain could result in a liability for alternative minimum tax.

TIF Solution Sixteen - 13

Part A - Tax Consequences Of Transfer

With respect to the land, the $250,000 elected value will be both the proceeds of disposition to Mr. Bodin and the adjusted cost base to the corporation. As the elected value is equal to Mr. Bodin's adjusted cost base, there will be no tax consequences resulting from the transfer.

The elected value and proceeds of disposition for the building is $750,000, an amount that is less than its capital cost but more than its UCC. This will result in Mr. Bodin having to report recapture of $116,400 ($750,000 - $633,600). The corporation's tax value will be $750,000. However, the corporation will retain the original capital cost of $1,100,000 ($1,350,000 - $250,000) for recapture and capital gains calculations. The $350,000 difference will be deemed to be CCA taken.

Part B - Adjusted Cost Base Of The Consideration

The adjusted cost base of all consideration received by Mr. Bodin will be the total elected value of $1,000,000 ($250,000 + $750,000). It will be allocated as follow:

Total Elected Value	$1,000,000
Total Non-Share Consideration	
($450,000 Assumed Mortgage + $400,000 New Debt)	(850,000)
Adjusted Cost Base Of Common Shares	$ 150,000

Part C - PUC Of The New Shares

The calculation of PUC would be as follows:

Increase In Legal Stated Capital (Fair Market Value)		$950,000
Less Excess Of:		
Elected Amount	($1,000,000)	
Over The Total Non-Share Consideration	850,000	(150,000)
Reduction In PUC		$800,000

The PUC of the common shares would be reduced to $150,000 ($950,000 - $800,000).

Part D - Sale Of Common Shares

The increase in Net Income For Tax Purposes from a sale of the shares for $950,000 would be as follows:

Proceeds Of Disposition	$950,000
Adjusted Cost Base	(150,000)
Capital Gain	$800,000
Inclusion Rate	1/2
Taxable Capital Gain	$400,000

As Taxable Income consequences are not required, the effect of the lifetime capital gains deduction has not been considered.

Part E - Tax Consequences Of Redemption

The tax consequences of a redemption for $950,000 would be as follows:

Proceeds From Redemption	$950,000
PUC	(150,000)
ITA 84(3) Deemed Dividend (Non-Eligible)	$800,000

There would be no capital gain on this redemption as shown in the following calculation:

Redemption Proceeds	$950,000
ITA 84(3) Deemed Dividend	(800,000)
Deemed Proceeds Of Disposition	$150,000
Adjusted Cost Base	(150,000)
Capital Gain	Nil

The amount to be included in Net Income For Tax Purposes would be $936,000, the $800,000 deemed non-eligible dividend grossed up by 17 percent.

There would also be a federal dividend tax credit of $98,483 [(21/29)(17%)($800,000)]. However, as the problem only asks for the amounts to be included in Net Income For Tax Purposes, this is not a required part of the solution.

TIF Solution Sixteen - 14

Part A - Receivables And Temporary Investments

If the Accounts Receivable are transferred under ITA 85, no election can be made under ITA 22. As a result, the $8,000 ($120,000 - $112,000) loss will be a capital loss, which will be disallowed under ITA 40(2)(g) because the transfer is to a corporation controlled by the transferor. The appropriate treatment would be to exclude the Accounts Receivable from the ITA 85 election. This would permit the use of the ITA 22 election that would allow the $8,000 loss to be treated as a fully deductible business loss. As ITA 22 is a joint election, the corporation would have to include the $8,000 in income, but could then deduct actual bad debts as they occur.

With respect to the Temporary Investments, ITA 40(2)(g) would deny the $5,000 ($42,000 - $37,000) capital loss on a transfer to a controlled corporation, without regard to whether the transfer is made under the provisions of ITA 85. This means that there is no point in transferring these investments to the corporation. Ms. Delmor could continue to hold the securities personally or, alternatively, sell them to an arm's length party. The allowable capital loss on such a sale would be immediately deductible, provided that Ms. Delmor has available sufficient taxable capital gains. If she does not, she might wish to structure the ITA 85 rollover in such a fashion that $5,000 in capital gains are generated by the transfer.

Part B - Minimum Elected Values

The minimum elected values would be as follows:

Accounts Receivable	$ 112,000
Temporary Investments	37,000
Inventories	220,000
Class 8 Depreciable Assets (See Note)	53,000
Machinery	197,000
Land	150,000
Building	416,000
Goodwill	1
Total Elected Value	$1,185,001

Note The minimum elected value for a depreciable property, under ITA 85(1)(e), is the least of the UCC for the class, the cost of the individual property, and the fair market value of the individual property. For the two Class 8 assets, these amounts would be as follows:

Asset A (Least Of $53,000, $27,000, And $32,500)	$27,000
Asset B (Least Of $53,000, $33,000, And $29,000)	29,000
Total	$56,000

If this amount is used, the result will be recapture of $3,000 ($56,000 - $53,000). However, ITA 85(1)(e.1) allows the assets to be transferred one at a time in order to avoid this result. Therefore, if Asset A is transferred first, the UCC balance will be $26,000 ($53,000 - $27,000). This means that when Asset B is transferred, the least amount will be the UCC of $26,000 and, when this is subtracted, the UCC balance will be nil and no recapture will arise on the transfer.

Part C - Adjusted Cost Base Of The Consideration

The adjusted cost base of the non-share consideration would be its fair market value which, in the case of debt, would be its face value of $872,000 ($800,000 in new debt, plus $72,000 of old debt assumed). Given this, the allocations to preferred stock and common stock would be as follows:

Total Elected Value	$1,185,001
Non-Share Consideration	(872,000)
Available For Common And Preferred Shares	$ 313,001
ACB Of Preferred Stock (Fair Market Value)	(200,000)
ACB Of Common Stock (Residual)	$ 113,001

(The following paragraph is not required.)

As Ms. Delmor will control the new corporation, the capital losses of $8,000 on Accounts Receivable and $5,000 on Temporary Investments will be disallowed under ITA 40(2)(g). The disallowed losses will be added to the tax cost of the assets on Delmor Inc.'s books. This means the Accounts Receivable will have a tax cost of $120,000 and the Temporary Investments will have a tax cost of $42,000 for Delmor Inc. Any bad debt losses on the Accounts Receivable will be capital losses.

Part C - PUC Of The Preferred And Common Shares

The PUC calculation would begin with the legal stated values of the shares. These were $200,000 for the preferred stock and $677,000 for the common stock. ITA 85(2.1) would require a reduction in this total as follows:

Total Increase In Legal Stated Capital Of Shares ($200,000 + $677,000)		$877,000
Less Excess Of:		
Total Elected Value	($1,185,001)	
Over The Total Non-Share Consideration	872,000	(313,001)
Reduction In PUC		$563,999

The PUC reduction would be allocated on the basis of fair market values as follows:

Preferred Stock [($563,999)($200,000 ÷ $877,000)]	$128,620
Common Stock [($563,999)($677,000 ÷ $877,000)]	435,379
Total PUC Reduction	$563,999

Subsequent to applying this reduction, the remaining PUC of the two classes of shares would be as follows:

	Preferred Stock	Common Stock
Legal Stated Capital	$200,000	$677,000
PUC Reduction (From Preceding)	(128,620)	(435,379)
Total PUC	$ 71,380	$241,621

The total PUC of $313,001 ($71,380 + $241,621) is equal to the difference between the elected value of $1,185,001 and the non-share consideration of $872,000. It is also equal to the total adjusted cost base of the two classes of shares ($200,000 + $113,001).

Part D - Tax Consequences Of Redemption

The tax consequences for Ms. Delmor on the redemption of the preferred stock and common stock would be as follows:

	Preferred Stock	Common Stock
Redemption Proceeds	$200,000	$677,000
PUC (Part C)	(71,380)	(241,621)
ITA 84(3) Deemed Dividend (Non-Eligible)	$128,620	$435,379
Redemption Proceeds	$200,000	$677,000
ITA 84(3) Deemed Dividend	(128,620)	(435,379)
Deemed Proceeds Of Disposition	$ 71,380	$241,621
Adjusted Cost Base	(200,000)	(113,001)
Capital Gain (Loss)	($128,620)	$128,620

Ms. Delmor would have a deemed non-eligible dividend of $563,999 ($128,620 + $435,379). This is also the amount of the gain that was deferred through the use of Section 85 ($1,749,000 - $1,185,001).

The grossed up non-eligible dividend of $659,879 [(117%)($563,999)] would qualify for a federal dividend tax credit of $69,430 [(21/29)(17%)($563,999)].

There is a net capital gain of nil ($128,620 - $128,620).

TIF Solution Sixteen - 15

Part A

As the fair market value of the consideration received by Ms. Chadwick was less than the reassessed fair market value of the assets transferred, it would appear that Ms. Chadwick was inadvertently attempting to make a gift to a related party, Biff. Making this a reasonable conclusion is the fact that Biff is the only common shareholder of the new corporation.

ITA 85(1)(e.2) requires that any gift amount be added to the elected value with the total being used as the deemed proceeds of disposition without any increase in the adjusted cost base of the shares received.

The amount of the gift and the tax consequences of the transfer to Ms. Chadwick would be calculated as follows:

Fair Market Value Of Assets Transferred ($12,500,000 + $500,000)	$13,000,000
Less The Greater Of:	
• Fair Market Value Of Consideration Received = $12,500,000 ($850,000 + $1,150,000 + $6,000,000+ $4,500,000)	
• Elected Value = $9,820,000	(12,500,000)
Gift To Biff	$ 500,000

Based on the reassessment, the $500,000 will be added to the value of the land resulting in a taxable capital gain calculated as follows:

Deemed Elected Value = Deemed Proceeds Of Disposition ($9,820,000 + $500,000)	$10,320,000
Tax Values Of Assets Transferred	(9,820,000)
Capital Gain	$ 500,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 250,000

The adjusted cost base of the preferred shares received by Ms. Chadwick would be calculated as follows:

Elected Value (Original)	$9,820,000
Non-Share Consideration ($850,000 + $1,150,000 + $6,000,000)	(8,000,000)
Adjusted Cost Base Of Preferred Shares	$1,820,000

The required PUC reduction and resulting PUC for the preferred shares received by Ms. Chadwick would be calculated as follows:

Increase In Legal Stated Capital		$4,500,000
Excess, If Any Of:		
Deemed Elected Value ($9,820,000 + $500,000)	($10,320,000)	
Over Non-Share Consideration	8,000,000	(2,320,000)
PUC Reduction		$2,180,000
PUC Of Preferred Shares ($4,500,000 - $2,180,000)		$2,320,000

Part B

The tax consequences to Ms. Chadwick of having her shares redeemed would be as follows:

Proceeds Of Redemption	$4,500,000
PUC Of Shares	(2,320,000)
ITA 84(3) Deemed Dividend	$2,180,000

This deemed dividend would be grossed up to $2,550,600 [(117%)($2,180,000)] of Taxable Income and will generate a federal dividend tax credit of $268,366 [(21/29)(17%)($2,180,000)].

In addition to the ITA 84(3) deemed dividend, there will also be a taxable capital gain calculated as follows:

Proceeds Of Disposition	$4,500,000
ITA 84(3) Deemed Dividend	(2,180,000)
Adjusted Proceeds Of Disposition	$2,320,000
Adjusted Cost Base Of Shares	(1,820,000)
Capital Gain	$ 500,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 250,000

Part C

If Biff Bangor sells his shares for $550,000, the tax consequences would be as follows:

Proceeds Of Disposition	$550,000
Adjusted Cost Base Of Shares	(5,000)
Capital Gain	$545,000
Inclusion Rate	1/2
Taxable Capital Gain	$272,500

Economic Analysis (Not Required)

If Ms. Chadwick had simply sold her business assets for their reassessed fair market value, she would have had a combination of business income and capital gains totalling $3,180,000 ($13,000,000 - $9,820,000). Using the procedures described above, the result has the same $3,180,000 ($500,000 capital gain on the transfer, plus the deemed dividend of $2,180,000 resulting from the redemption, plus the $500,000 capital gain resulting from the redemption). While the composition of the income is different, the overall result is the same.

However, there is an impact on Biff. The $500,000 gift was added to the value of his shares with no corresponding increase in the adjusted cost base of the shares. In effect, this has become a component of the $545,000 capital gain that was recorded when he sold his shares.

At the time of the rollover, Biff's shares had a fair market value of $505,000, his investment of $5,000, plus the $500,000 gift. While the post rollover gain of $45,000 ($550,000 - $505,000) had nothing to do with the gift, $500,000 of the gain could have been avoided. In effect, this gain is being taxed twice, once in Biff's hands and once in Ms. Chadwick's hands.

Overall, the procedures used in this situation resulted in Ms. Chadwick being taxed on the same amount of income as would have been the case without the ITA 85(1) rollover. In addition, Biff paid taxes on an additional capital gain of $500,000 ($250,000 taxable amount) that would not have occurred if Ms. Chadwick had taken the time to determine the correct fair market value for the land and had proper documentation of the value.

TIF Solution Sixteen - 16

Part A

The immediate tax consequences of the transfer would be a taxable capital gain on the land and an ITA 15(1) shareholder benefit. These would be calculated as follows:

Elected Value Of Land	$256,000
Adjusted Cost Base	(220,000)
Capital Gain	$ 36,000
Inclusion Rate	1/2
Taxable Capital Gain On Land	$ 18,000

Fair Market Value Of Consideration ($800,000 + $562,000)	$1,362,000
Fair Market Value Of Transferred Assets	(1,112,000)
ITA 15(1) Shareholder Benefit	$ 250,000

The total effect on Taxable Income is as follows:

Taxable Capital Gain	$ 18,000
Shareholder Benefit	250,000
Total Addition To Net Income For Tax Purposes	$268,000
Net Capital Loss Carry Forward	(18,000)
Total Addition To Taxable Income	$250,000

The adjusted cost base of the preferred shares would be calculated as follows:

Elected Value ($123,000 + $256,000 + $462,000)	$841,000
Non-Share Consideration	(800,000)
Available For Shares	$ 41,000
ITA 15(1) Shareholder Benefit	250,000
Adjusted Cost Base Of Shares	$291,000

The PUC of the preferred shares would be calculated as follows:

Increase In Legal Stated Capital		$562,000
Less The Excess, If Any, Of:		
Elected Value	($841,000)	
Over The Non-Share Consideration	800,000	(41,000)
PUC Reduction		$521,000
PUC ($562,000 - $521,000)		$ 41,000

Part B

The tax values for the assets transferred can be described as follows:

Depreciable Assets The tax cost for these assets will be the elected value of $123,000. However, they will retain their original capital cost of $167,000 for recapture and capital gains calculations. The $44,000 difference will be deemed to be CCA taken.

Land The adjusted cost base of the land will be the elected value of $256,000. (Note that the rules in ITA 13(7)(e) to limit the capital cost on non-arm's length transfers do not apply to non-depreciable assets.)

Building The tax cost for this asset will be the elected value of $462,000. However, the building will retain its original capital cost of $514,000 for recapture and capital gains calculations. The $52,000 difference will be deemed to be CCA taken.

Part C-1 Sale Of Shares

If the shares were sold for $562,000, the results would be as follows:

Proceeds Of Disposition	$562,000
Adjusted Cost Base	(291,000)
Capital Gain	$271,000
Inclusion Rate	1/2
Taxable Capital Gain	$135,500

Part C-2 Redemption Of Shares

Alternatively, if the shares were redeemed, the results would be:

Proceeds Of Redemption	$562,000
PUC	(41,000)
ITA 84(3) Deemed Dividend	$521,000

For inclusion in Net Income For Tax Purposes, the ITA 84(3) dividend will be grossed up to $609,570 [(117%)($521,000)].

A federal dividend tax credit of $64,137 [(21/29)(17%)($521,000)] will also be generated.

The redemption will also result in a capital loss as follows:

Proceeds Of Disposition	$562,000
ITA 84(3) Deemed Dividend	(521,000)
Adjusted Proceeds Of Disposition	$ 41,000
Adjusted Cost Base	(291,000)
Capital Loss	($250,000)
Inclusion Rate	1/2
Allowable Capital Loss	($125,000)

The allowable capital loss could only be deducted to the extent of Mr. Gibber's taxable capital gains in the year of sale.

As a further point, notice that the total income of $271,000 resulting from the sale is the same as the total income resulting from the redemption ($521,000 - $250,000). However, because of the higher tax rate on dividends vs. capital gains, as well as the possibility that Mr. Gibber cannot use any, or all, of his allowable capital loss in the year of sale, the redemption result is much less favourable from a tax point of view.

TIF Solution Sixteen - 17

Part A - Tax Consequences Of Proposed Plan

Ms. Chadwick's plan involves the disposition of shares of a corporation resident in Canada to a corporation with which she does not deal at arm's length (Mr. Borque would be considered Ms. Chadwick's common-law partner.). Subsequent to the transaction, the two corporations are connected (Borque Inc. controls Norton Ltd.). Given these facts, the provisions of ITA 84.1 apply to this transaction.

The required calculations begin with the PUC reduction under ITA 84.1(1)(a):

Increase In Legal Stated Capital Of Borque Inc.		$1,590,000
Less The Excess, If Any, Of:		
Greater Of PUC And ACB Of Norton Ltd. Shares	($225,000)	
Over The Fair Market Value Of The Boot	875,000	Nil
PUC Reduction		$1,590,000

PUC After Reduction ($1,590,000 - $1,590,000)	Nil

The nil PUC reflects the fact that all of the PUC of the Norton Ltd. shares was taken out as non-share consideration.

The deemed non-eligible dividend under ITA 84.1(1)(b), and federal dividend tax credit, would be calculated as follows:

Increase In Legal Stated Capital Of Borque Inc.		$1,590,000
Fair Market Value Of Boot		875,000
Total		$2,465,000
PUC Of Norton Ltd. Shares	($ 225,000)	
PUC Reduction Under ITA 84.1(1)(a)	(1,590,000)	(1,815,000)
Deemed Dividend Under ITA 84.1(1)(b)		$ 650,000
Gross Up At 17 Percent		110,500
Taxable Non-Eligible Dividend		$ 760,500

Federal Dividend Tax Credit [(21/29)(17%)($650,000)]	$ 80,017

You will note that, because of the application of ITA 84.1, no capital gain eligible for the lifetime capital gains deduction results from this transaction. This can be seen in the following calculation:

Proceeds Before Adjustment Of Norton Shares (Elected Amount)	$875,000
ITA 84.1(1)(b) Deemed Dividend	(650,000)
Adjusted Proceeds Of Disposition (ITA 54)	$225,000
Adjusted Cost Base Of Shares	(225,000)
Capital Gain	Nil

Part B - An Improved Solution

The approach suggested by Ms. Chadwick will not be successful in producing the required $650,000 capital gain. The reason that this approach cannot be successful is that Ms. Chadwick is trying to take out non-share consideration in excess of the $225,000 PUC and ACB of her Norton Ltd. shares. Fortunately, this situation can be corrected by reducing the amount of non-share consideration to $225,000. In conjunction with this reduction in the amount of non-share consideration, the PUC and fair market value of the retractable preferred shares will have to be increased to $2,240,000, so that the total fair market value of the consideration received by Ms. Chadwick equals $2,465,000, the fair market value of the Norton Ltd. shares given up in the transaction. Using this approach, the required PUC reduction under ITA 84.1(1)(b) would be as follows:

Increase In Legal Stated Capital Of Borque Inc.		$2,240,000
Less The Excess, If Any, Of:		
Greater Of PUC And ACB Of Norton Ltd. Shares	($225,000)	
Over The Fair Market Value Of The Boot	225,000	Nil
PUC Reduction		$2,240,000
PUC After Reduction ($2,240,000 - $2,240,000)		Nil

The deemed non-eligible dividend under ITA 84.1(1)(b) would be calculated as follows:

Increase In Legal Stated Capital Of Borque Inc.		$2,240,000
Fair Market Value Of Boot		225,000
Total		$2,465,000
PUC Of Norton Ltd. Shares	($ 225,000)	
PUC Reduction Under 84.1(1)(b)	(2,240,000)	(2,465,000)
Deemed Dividend Under ITA 84.1(1)(b)		Nil

Given the preceding, the capital gain resulting from this transaction is calculated as follows:

Proceeds Before Adjustment Of Norton Ltd. Shares (Elected Amount)	$875,000
ITA 84.1(1)(b) Deemed Dividend	Nil
Proceeds Of Disposition	$875,000
Adjusted Cost Base Of Norton Ltd. Shares	(225,000)
Capital Gain	$650,000

There would be no tax consequences using this approach, except for the possibility that the alternative minimum tax may be payable. While there would be a $650,000 capital gain, it could be completely eliminated by using Ms. Chadwick's lifetime capital gains deduction.

Part C - Sale Of Shares

As in the other Parts of this question, there is a sale of shares by an individual to a corporation with which the individual is not at arm's length. This means that ITA 84.1 is still applicable.

As no new Borque Inc. shares are issued, no PUC reduction is required.

The ITA 84.1(1)(b) deemed non-eligible dividend would be calculated as follows:

Increase In Legal Stated Capital Of Borque Inc.		Nil
Non-Share Consideration Of Shares Sold [(6,530 Shares)($2,465,000 ÷ 22,500)]		$715,398
Total		$715,398
PUC Of Norton Ltd. Shares [(6,530 Shares)($10)]	($65,300)	
PUC Reduction Under ITA 84.1(1)(a)	Nil	(65,300)
Deemed Dividend Under ITA 84.1(1)(b)		$650,098

The taxable non-eligible dividend of $760,615 [(117%)($650,098)] would qualify for a federal dividend tax credit of $80,029 [(21/29)(17%)($650,098)]. Given this deemed dividend, the sale of shares will not result in the desired capital gain. This can be seen in the following calculation:

Unadjusted Proceeds Of Disposition [(6,530 Shares)($2,465,000 ÷ 22,500)]	$715,398
Deemed Dividend Under ITA 84.1(1)(b)	(650,098)
Adjusted Proceeds Of Disposition	$ 65,300
Adjusted Cost Base Of Shares [(6,530 Shares)($10)]	(65,300)
Capital Gain	Nil

TIF Solution Sixteen - 18

Part A

As a dividend has been paid in conjunction with a disposition of property to an arm's length party, ITA 55(2) is applicable. This legislation is designed to prevent capital gains strips. As a result, the following calculation is required for the dividend received by Lardley:

Dividends Received From Domas	$2,000,000
Dividend Attributable To Safe Income (Tax Free)	(565,000)
Deemed Proceeds Of Disposition Under ITA 55(2)(b)	$1,435,000
Actual Proceeds Of Disposition From Ms. Arden	300,000
Total Proceeds Of Disposition	$1,735,000
Adjusted Cost Base	(300,000)
Capital Gain	$1,435,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 717,500

As shown, $565,000 of the funds would be received by Lardley as a dividend from safe income and could be deducted under ITA 112, resulting in no tax cost. However, the remainder would be converted to deemed proceeds of disposition, resulting in a taxable capital gain of $717,500.

Part B

As the value elected for the ITA 85 rollover was equal to the adjusted cost base of the shares, there would be no tax consequences associated with the transfer of shares. The redemption would normally result in a deemed dividend under ITA 84(3). However, as the redemption was in conjunction with a disposition of the property to an arm's length purchaser, ITA 55(2) alters this conclusion as follows:

Redemption Proceeds	$2,300,000
Paid Up Capital Of Preferred Shares	(300,000)
ITA 84(3) Deemed Dividend	$2,000,000
Amount Deemed Not To Be A Dividend Under ITA 55(2)(a) ($2,000,000 - $565,000)	(1,435,000)
Remaining ITA 84(3) Deemed Dividend (Tax Free)	$ 565,000

Redemption Proceeds	$2,300,000
ITA 84(3) Deemed Dividend	(565,000)
ITA 54 Deemed Proceeds Of Disposition	$1,735,000
Adjusted Cost Base	(300,000)
Capital Gain	$1,435,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 717,500

The overall result would be the same as in Part A. That is, a $565,000 tax free dividend and a taxable capital gain of $717,500.

Chapter Seventeen Test Item File Solutions

TIF Solution Seventeen - 1

1. The usual situation in which ITA 85.1 is applied involves a shareholder of a Canadian corporation (Corporation A) who wishes to sell his shares, on an arm's length basis, to another Canadian corporation (Corporation B). ITA 85.1 allows the shareholder to exchange his shares in Corporation A for shares of Corporation B, with the transaction taking place at the adjusted cost base of the Corporation A shares. That is, the proceeds of disposition for the Corporation A shares will be their adjusted cost base, and this will also be the cost of these shares to the acquiring company. The major tax advantage is the fact that any gain on the Corporation A shares is deferred until such time as the Corporation B shares are sold.

2. The basic rules are that the vendor is deemed to have (1) disposed of the exchanged shares for proceeds of disposition equal to their adjusted cost base, and (2) acquired the shares of the purchaser at a cost to the vendor equal to the adjusted cost base to the vendor of the exchanged shares immediately before the exchange.

3. The required three can be chosen from the following:
   - The vendor’s shares must be held as capital property.
   - The vendor and purchaser must be dealing with each other at arm’s length.
   - The vendor, or persons with whom he does not deal at arm’s length, cannot control the purchaser immediately after the exchange. Likewise, they cannot own shares having a fair market value in excess of 50 percent of the total fair market value of the purchasing corporation’s outstanding shares.
   - The vendor and purchaser cannot have filed an election under ITA 85 with respect to the exchanged shares.
   - The vendor must not have received any consideration, other than shares of the purchaser, in return for the shares given up in the exchange.

4. The vendor opts out by recording the share exchange at fair market value. This will result in the vendor including the resulting capital gain or loss in their income tax return. Note that, unlike a transfer under Section 85, the only value that can be used in opting out is the fair market value of the shares exchanged. A lower value cannot be elected.

5. Under ITA 86, Mr. Barris could exchange his common shares in Barris Ltd. for some combination of non-share consideration and redeemable preferred shares, with a total fair market value equal to the $3 million fair market value of the common shares. As long as the non-share consideration does not exceed the $50,000 PUC and adjusted cost base of the common shares, there would be no immediate tax consequences to Mr. Barris. As the preferred shares now represent 100 percent of the value of Barris Ltd., common shares could be sold to the children for a nominal amount of consideration. In order for Mr. Barris to retain control, the preferred shares should be voting and, if the common shares are also voting, the number of preferred shares should exceed the number of common shares issued.

6. The required two conditions can be selected from the following:
    - The original owner's shares must be capital property to the owner. They cannot be part of an inventory of securities that is being held for trading purposes.
    - The transaction must result in an exchange of all of the outstanding shares of a particular class that are owned by the transferor.
    - The share exchange must be integral to a reorganization of the capital of the corporation.
    - The transferor must receive shares of the capital stock of the corporation.

7. The required three provisions could be selected from the following:
    - The preferred shares must be redeemable at the option of the shareholder.
    - The preferred shares should be entitled to a dividend at a reasonable rate.
    - The corporation must guarantee that dividends will not be paid on any other class of shares, if the payment would result in the corporation having insufficient net assets to redeem the preferred shares at their specified redemption price.
    - The preferred shares must become cumulative if the fair market value of the net assets of the corporation falls below the redemption value of the preferred shares, or if the corporation is unable to redeem the shares on a call for redemption.
    - The preferred shares should have preference on liquidation of the corporation.

8. The adjusted cost base of the new shares issued in an ITA 86(1) reorganization would be equal to the adjusted cost base of the old shares redeemed, less any non-share consideration. However, if a gift is involved, ITA 86(2) is applicable. In this case, the adjusted cost base of the new shares will be equal to the adjusted cost base of the old shares, reduced by the sum of any non-share consideration plus the amount of the gift.

9. The paid up capital (PUC) of new shares issued in either an ITA 86(1) or and ITA 86(2 reorganization would be equal to their legal stated capital, less a PUC reduction. This reduction calculation would start with the legal stated capital of the shares. From this total, the formula requires the subtraction of any excess of the PUC of the old shares over any non-share consideration received. If the non-share consideration exceeds the old PUC, the reduction will be equal to the legal stated capital, resulting in a PUC of nil. This calculation is not altered by the presence of a gift to a related party.

10. The proceeds of redemption are equal to the sum of any non-share consideration received, plus the PUC of the new shares issued to redeem the old shares. The proceeds of disposition are equal to the sum of any non-share consideration received, plus the adjusted cost base of the new shares issued to redeem the old shares. In those cases where the PUC and adjusted cost base of the old shares are equal, the amount of both proceeds will be equal.

11. The initial PUC is equal to the legal stated capital of the new shares issued. However, this value is subject to a PUC reduction equal to the legal stated capital of the new shares, reduced by the excess, if any, of the PUC of the old shares over the non-share consideration provided in the redemption. This reduction value is subtracted from the legal stated capital to arrive at a final figure for the PUC of the new shares. In those cases where the non-share consideration equals or exceeds the PUC of the old shares, the PUC reduction is equal to the legal stated capital of the new shares, resulting in a final figure for PUC of nil.

12. The basic condition for a gift to be present is that the fair market value of the old shares exceeds the sum of the fair market value of the new shares and the fair market value of the non-share consideration received. In addition, a related party must be in a position to benefit from this difference. This would generally require that the related party be holding common shares in the reorganized corporation.

13. The modifications can be described as follows:

- Under ITA 86(2)(e), the cost to the taxpayer of the new shares will be equal to the cost of the old shares, less the sum of the non-share consideration plus the gift. This compares to a cost for the new shares under ITA 86(1)(b) equal to the cost of the old shares, less any non-share consideration.
- Under ITA 86(2)(c), the proceeds of the disposition for capital gains purposes on the old shares will be equal to the lesser of the non-share consideration plus the gift, and the fair market value of the old shares. This compares to the proceeds of disposition under ITA 86(1)(c), which is equal to the cost of the new shares, plus any non-share consideration.
- Under ITA 86(2)(d), any capital loss resulting from the disposition of the old shares will be deemed to be nil. There is no such restriction under ITA 86(1).

14. As described in the text, the major advantages of using ITA 86(1) are as follows:

- An ITA 86(1) share reorganization may be simpler to implement than a Section 85 rollover as it does not involve setting up a new corporation.
- The corporate law steps are easier, only requiring shares to be exchanged, and possibly new share classes to be formed.
- The use of ITA 86(1) does not require an election to be filed with the CRA.

15. The required two conditions can be selected from the following:

- All of the predecessor corporations must be taxable Canadian corporations.
- All shareholders of the predecessor corporations must receive shares of the amalgamated corporation due to the amalgamation.
- All of the assets and liabilities of the predecessor corporations, other than intercompany balances, must be transferred to the amalgamated corporation in the amalgamation.
- The transfer cannot simply be a normal purchase of property, or involve the distribution of assets on the winding-up of a corporation. It must be supported by corporate legislation which identifies the transaction as an amalgamation.

16. The shareholders of the predecessor corporations are deemed to have disposed of their shares for proceeds equal to the adjusted cost base of the shares. In addition, they are deemed to have acquired the shares of the amalgamated company at the same value.

17. ITA 88(1) deals with the wind-up of a subsidiary in which the parent company owns 90 percent or more of the voting shares. It is a rollover provision that allows the subsidiary assets to be transferred to the parent, essentially at tax values. ITA 88(2) deals with all other corporate wind ups. It is not a rollover provision.

18. The limits on the asset bump up are described in the text as follows:

    - The basic amount of the bump-up is found in ITA 88(1)(d)(i) and (i.1). This amount is the excess of the adjusted cost base of the subsidiary shares held by the parent, over the sum of:
        - the tax values of the subsidiary's net assets at the time of the winding-up; and
        - dividends paid by the subsidiary to the parent since the time of the acquisition (including capital dividends).
    - ITA 88(1)(d)(ii) further limits the amount that can be recognized to the excess of the fair market value of the subsidiary's non-depreciable capital property over their tax values at the time the parent acquired control of the subsidiary.

19. Under ITA 88(1), which applies when the parent owns 90 percent or more of each class of the subsidiary's shares, there is a provision that allows some part of any excess of the cost of the subsidiary, over the underlying tax values of its assets to be recognized in the tax records of the combined company. More specifically, any excess of the fair market value of non-depreciable property over its cost at the time that the subsidiary was acquired can be included in the transfer, to the extent that the value is supported by the price paid for the shares. This same provision is also available under ITA 87, but only in those cases where the parent owns 100 percent of the subsidiary's shares. This means that the only real difference with respect to the availability of this "bump-up" is that its applicability is more limited under ITA 87, since it can only be used when ownership is 100 percent.

    A second difference between these two provisions involves the use of loss carry forwards. In the case of an ITA 87 amalgamation, loss carry forwards can be used immediately after the amalgamation transaction takes place. In the case of an ITA 88(1) wind-up, subsidiary loss carry forwards will not become available until the first taxation year of the parent that begins after the date that the wind-up period commences.

    A third difference is that, in an amalgamation, CCA can be claimed in the last year of the predecessor corporations and the first year of the amalgamated corporation. In the case of a wind-up under ITA 88(1), the subsidiary will not be able to take CCA in the year of the wind-up.

    A final difference is that, in an amalgamation, both predecessor companies have a deemed year end. In the ITA 88(1) wind-up, the parent company does not have a deemed year end.

20. The components may consist of the following amounts:

    - Tax-free PUC amounts.
    - Tax-free capital dividends.
    - Taxable dividends, including any balance in the RDTOH.
    - Proceeds of disposition for the shares.

21. The conversion transaction involves a disposition of a debt security, along with the acquisition of common shares. The proceeds of disposition for the debt security would be the more valuable common shares and, in the absence of a special provision, the result would be a capital gain. However, relief is found in ITA 51(1). ITA 51(1)(c), deems such exchanges not to be a disposition. Given that there is no disposition, no gain will be recognized. Going with this, ITA 51(1)(d) deems the cost of the acquired shares to be equal to the cost of the shares or debt given up. These provisions, in effect, permit a tax free exchange of the two types of securities.

22. The three exceptions are as follows:

- In cases where the payment relates to past employment with the payor, the receipt will be treated by the recipient as employment income.
- When intangible capital property is being sold and the payor and the recipient jointly elect in prescribed form, the payment can be treated by the recipient as a deduction from cumulative eligible capital (CEC).
- In a situation where a restrictive covenant is sold in conjunction with an eligible interest, the amount received can be added to the proceeds of disposition.

23. The failure to allocate a value to leaseholds in the purchase agreement, and the resulting allocation of these values to goodwill, has the following effects:

Vendor If the proceeds are allocated to the lease, any excess over the tax value of the lease (usually nil) will be treated as a capital gain, only one-half of which would be taxable. Provided a CCPC is involved, this gain will be a component of investment income. This means that while it will be subject to ART and not eligible for the GRR, a large portion of the Part I tax paid will be refundable.

If the proceeds are allocated to goodwill, three-quarters of the amount will be deducted from the cumulative eligible capital balance. If no deductions of CEC have been made under ITA 20(1)(b) in the past, this negative balance will be multiplied by two-thirds prior to its inclusion in the taxpayer's income. This multiplication reduces the amount from a three-quarters inclusion, to a one-half inclusion [(3/4)(2/3) = 1/2].

The treatment is different if previous deductions have been made under ITA 20(1)(b). In this case, a negative balance will be added to income, without adjustment, to the extent of previous deductions made under ITA 20(1)(b). If the negative amount exceeds amounts previously deducted under ITA 20(1)(b), the excess will be multiplied by two-thirds prior to its addition to income. In this case, the total income addition will be larger than it would have been if the proceeds had been allocated to a lease.

Without regard to the amount of the inclusion, it will be considered to be active business income rather than investment income. This means that it may be eligible for the small business deduction.

Purchaser The distinction between allocation to a leasehold interest and allocation to goodwill is more significant to the purchaser. If the value is allocated to goodwill, only three-quarters of the amount will be deductible. In contrast, an allocation to a leasehold interest would result in the entire amount being deductible. If the lease is relatively short, a further advantage may arise in that the leasehold interest can be written off over its life, while three-quarters of the goodwill will be amortized at a maximum rate of 7 percent per year on the declining balance in the account.

24. **Accounts Receivable** In general terms, the sale of accounts receivable is treated as a capital transaction. This means that losses are capital in nature. However, any bad debt reserve from the previous year must be brought into income. There is a joint election available under ITA 22 that will allow the vendor to fully deduct bad debt losses, provided the purchaser agrees to include bad debt recoveries in income.

Inventory Gains and losses on the sale of inventories would be included in full in the computation of Net Income For Tax Purposes.

Depreciable Assets The situation here is fairly complex and involves a number of possibilities. They can be outlined as follows:

1. If the proceeds exceed the capital cost, the excess will be treated as a capital gain. In addition, the difference between the UCC and the capital cost will be included in income as recapture of CCA.
2. If the proceeds are less than the balance in the UCC of the class and there are no other assets in the class, the deficiency will be fully deductible as a terminal loss.
3. If the proceeds are less than the capital cost but more than the UCC balance, the excess will be treated as recapture.

Goodwill Three-quarters of the proceeds from the sale of goodwill is deducted from the balance in the corporation's cumulative eligible capital account.

If a positive balance remains in the CEC account, the situation is similar to that involving terminal losses on depreciable capital assets. As with such terminal losses, the balance remaining could be deducted in the computation of Net Income For Tax Purposes. In similar fashion, any CEC balance that is left when a business terminates can also be deducted. However, an important difference from the terminal loss situation on depreciable assets is that the deductible amount of any loss on CEC is only three-quarters of the actual amount of the loss. As is the case with terminal losses, any amount deducted from income is also deducted from the CEC balance, in order to leave a balance of nil.

If the CEC balance is negative, ITA 14(1) requires that the negative balance be divided into two components. These components, along with their tax treatment, are as follows:

- 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 that is analogous to that given to capital gains, it will be multiplied by two-thirds prior to its inclusion in the taxpayer's income. This multiplication reduces the amount from a three-quarters inclusion, to a one-half inclusion [(3/4)(2/3) = 1/2].

25. The three reasons can be selected from the following:

- In acquiring assets, the purchaser acquires a completely new, and usually higher, set of tax values for the assets transferred. This will result in higher CCA claims and/or lower gains on future dispositions.
- Goodwill (cumulative eligible capital) can be recognized when assets are acquired. The CEC deductions related to these amounts are not available if shares are acquired.
- If shares are acquired, all of the assets must be acquired. If redundant assets are present, they can be left out of an acquisition of assets.
- If shares are acquired, the purchaser may become responsible for any future tax reassessments. While this exposure could occur because the purchased corporation continues to operate, it is usually covered in the buy and sell agreement for the transaction. This agreement is normally written to protect the purchaser from future problems in this area.
- If shares are acquired, the purchaser may become responsible for potential non-tax liabilities related to product or environmental liabilities. However, this is another issue that is normally dealt with in the buy and sell agreement.

TIF Solution Seventeen - 2

New For 2016/2017

1. True.

2. True.

3. False.

4. False

5. True

6. False. They can be used immediately.

7. True.

8. False. The excess will be treated as an ITA 84(2) deemed dividend.

9. True.

10. False. There are exceptions that don't require the full amount of the payment to be included in in the taxpayer's Net Income For Tax Purposes (e.g., payments related to cumulative eligible capital, only three-fourths of which will be included in Net Income For Tax Purposes).

Retained From Previous Editions

11. True.

12. False. Such a transfer cannot be made under ITA 86(1).

13. False. The only requirement is that he transfer all of the shares that he owns of a particular class.

14. True.

15. False. Such gifts may occur when the fair market value of the shares received is less than the fair market value of the shares given up.

16. False. ITA 88(1) can only be used when there is 90 percent or greater ownership of the subsidiary.

TIF Solution Seventeen - 3

New For 2016/2017

1. C. The vendor can receive a combination of shares and non-share consideration in return for the shares he is giving up.

2 B. $560,000.

The calculation of this amount would be as follows:

Increase In Legal Stated Capital		$700,000
PUC - Old Shares [(70%)($2,300,000)]	($1,610,000)	
Non-Share Consideration	1,050,000	(560,000)
PUC Reduction		$140,000

This will leave a PUC of $560,000 ($700,000 - $140,000)

3. D. The depreciable capital property of the predecessor companies will be carried forward to the tax records of the amalgamated company at UCC values.

4. B. By bringing together a profitable and an unprofitable company, an amalgamation can result in a faster write off of capital assets through CCA deduction.

5. B. The bump up is only available in a wind up when the parent company owns 100 percent of the subsidiary.

6. A. Deemed dividend on winding-up of $405,000 ($450,000 - $45,000). This is made up of a capital dividend of $51,000 and a taxable non-eligible dividend of $354,000.

7. C. The ability to recognize the acquired company's goodwill.

Retained From Previous Editions

8. C. ITA 85.1 - Share for share exchange.

9. C. The vendor can receive cash equal to an amount of the PUC of the shares tax-free.

10. B. Ms. Takase will be deemed to have disposed of her Takase Ltd. shares for an amount equal to their ACB. There will not be a capital gain to report on this disposition.

11. B. $28,000, her ACB for the Zoom shares.

12. A. All of the outstanding shares of the particular class must be exchanged. This is not required. The only requirement is that all of the shares of that class that are held by the transferor must be exchanged.

13. D. Voting rights.

14. B. The PUC of the new shares will be equal to their legal stated capital.

15. A. Nil. The adjusted cost base would be the $600,000 adjusted cost base of the old shares, less the $600,000 in non-share consideration received.

16. C. The adjusted cost base will be nil, the cost of the old shares, less the sum of the non-share consideration and the gift ($960,000 - $500,000 - $460,000).

17. A. Mamma Mia could restructure the ownership of her company, which would result in no immediate tax consequence for herself, with future growth accruing to her son.

18. B. A reorganization of share capital

19. A. All the predecessor corporations must be Canadian controlled private corporations.

20. A. RDTOH of a public company. Public companies do not have an RDTOH.

21. C. The shareholders must receive non-share consideration that is equal to the adjusted cost base of their shares.

22. D. If the parent owns more than 90% of the shares of each class of capital stock of the subsidiary, it will be possible to combine the companies using either ITA 87 or ITA 88(1).

23. C. Parent Inc. will be able to utilize the non-capital loss against profits from the same business in which the loss was incurred beginning in the 2016 taxation year. The net capital loss cannot be utilized by Parent Inc.

24. B. All of the predecessor corporations must be Canadian controlled private corporations.

25. B. Both the subsidiary and the parent will have a deemed year end.

26. B. LRIP balances will only flow through to the parent if the subsidiary was a CCPC.

27. B. November 30, 2017.

28. B. The bump up gives partial recognition to the fact that the cost of acquiring a subsidiary usually exceeds both the carrying value and the sum of the fair values of the acquired identifiable assets.

29. A. Jasmine will receive dividends subject to tax of $1,500,000 ($2,000,000 - $100,000 - $400,000), as well as a taxable capital gain of $25,000 [($2,000,000 - $1,900,000 - $50,000)(1/2)], when she receives the $2,000,000 distribution.

30. D. $101,000 [PUC ($1,000) + CDA ($100,000)]

31. B. No capital gain.

32. D. The exchange must not involve any consideration other than the securities being exchanged.

33. A. Nancy will realize a capital gain of $1,866,667, resulting in a taxable capital gain of $933,334. She will pay $466,667 in taxes, leaving her with $2,000,000.

    The supporting calculation is:
    X - [(X - $600,000)(1/2)(50%)] = $2,000,000
    X - (0.25X - $150,000) = $2,000,000
    0.75X + $150,000 = $2,000,000
    0.75X = $1,850,000
    X = $2,466,667

34. C. Linden will report active business income of $212,500, and there will be a $212,500 addition to the capital dividend account.

35. C. Yamaguchi will be held liable for future tax reassessments of Ito Inc.

36. D. The corporation may be subject to taxes on business income and capital gains.

TIF Solution Seventeen - 4

Exam Exercise Solution Seventeen - 1 (Share For Share Exchange)

The transaction involves a share for share exchange that meets the conditions of ITA 85.1. Unless Mr. Forbes opts out of this rollover provision in his income tax return, the tax consequences of this transaction for him would be as follows:

- Mr. Forbes would be deemed to have disposed of his Forbes Ltd. shares at a value equal to their adjusted cost base of $540,000. As a consequence, there would be no capital gain on the disposition.
- Mr. Forbes would be deemed to have acquired his Megopolis Ltd. shares at a cost equal to the adjusted cost base of the Forbes Ltd. shares, or $540,000.
- The adjusted cost base of the Forbes Ltd. shares that have been acquired by Megopolis Ltd. would be deemed to be the lesser of their fair market value and their paid up capital. In this case, the $540,000 paid up capital amount is the lower figure.
- The PUC of the Megopolis Ltd. shares that have been issued to Mr. Forbes would be $540,000, the PUC of the Forbes Ltd. shares that were given up.

Exam Exercise Solution Seventeen - 2 (Share For Share Exchange)

This transaction involves a share for share exchange that meets the conditions of ITA 85.1. Unless Mr. Gage opts out of this rollover provision in his income return, the tax consequences of this transaction would be as follows:

- Mr. Gage would be deemed to have disposed of his Farnum Ltd. shares at their adjusted cost base of $700,000.
- Mr. Gage would be deemed to have acquired his Gross Enterprises shares at a cost equal to the $700,000 adjusted cost base of the Farnum Ltd. shares.
- The adjusted cost base of the Farnum Ltd. shares that have been acquired by Gross Enterprises would be deemed to be the lesser of their fair market value of $1,200,000 and their paid up capital. In this case, the $400,000 paid up capital amount is the lower figure.
- The PUC of the Gross Enterprises shares that have been issued to Mr. Gage would be $400,000, the PUC of the Farnum Ltd. shares that were given up.

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

The required PUC reduction on the redeemable preferred shares would be calculated as follows:

Increase In Legal Stated Capital		$1,575,000
Less The Excess, If Any, Of:		
PUC Of Common Shares	($1,375,000)	
Over The Non-Share Consideration	1,375,000	Nil
PUC Reduction		$1,575,000

This means that the redeemable preferred shares would have a PUC of nil ($1,575,000 - $1,575,000).

The adjusted cost base of the redeemable preferred shares would be calculated as follows:

Adjusted Cost Base Of Common Shares	$1,375,000
Non-Share Consideration	(1,375,000)
Adjusted Cost Base Of Redeemable Preferred Shares	Nil

Because Laura took back cash equal to her PUC and ACB, there would be no ITA 84(3) deemed dividend and no capital gain or loss. These calculations would be as follows:

PUC Of New Shares	Nil
Plus Non-Share Consideration	$1,375,000
Proceeds Of Redemption Under ITA 84(5)(d)	$1,375,000
PUC Of Old Shares	(1,375,000)
ITA 84(3) Deemed Dividend	Nil

Adjusted Cost Base Of New Shares	Nil
Plus Non-Share Consideration	$1,375,000
Proceeds Of Disposition Under ITA 86(1)(c)	$1,375,000
ITA 84(3) Deemed Dividend	Nil
Adjusted Proceeds	$1,375,000
Adjusted Cost Base Of Old Shares	(1,375,000)
Capital Gain (Loss)	Nil

Exam Exercise Solution Seventeen - 4 (Exchange Of Shares In Reorganization)

The required PUC reduction on the redeemable preferred shares would be calculated as follows:

Increase In Legal Stated Capital		$700,000
Less The Excess, If Any, Of:		
PUC Of Common Shares	($200,000)	
Over The Non-Share Consideration	200,000	Nil
PUC Reduction		$700,000

This means that the redeemable preferred shares would have a PUC of nil ($700,000 - $700,000).

The adjusted cost base of the redeemable preferred shares would be calculated as follows:

Adjusted Cost Base Of Common Shares	$200,000
Non-Share Consideration	(200,000)
Adjusted Cost Base Of Redeemable Preferred Shares	Nil

Because Mr. Red took back cash equal to his PUC and ACB, there would be no ITA 84(3) deemed dividend and no capital gain or loss. These calculations would be as follows:

PUC Of New Shares	Nil
Plus Non-Share Consideration	$200,000
Proceeds Of Redemption Under ITA 84(5)(d)	$200,000
PUC Of Old Shares	(200,000)
ITA 84(3) Deemed Dividend	Nil

Adjusted Cost Base Of New Shares	Nil
Plus Non-Share Consideration	$200,000
Proceeds Of Disposition Under ITA 86(1)(c)	$200,000
ITA 84(3) Deemed Dividend	Nil
Adjusted Proceeds	$200,000
Adjusted Cost Base Of Old Shares	(200,000)
Capital Gain (Loss)	Nil

Exam Exercise Solution Seventeen - 5 (Exchange Of Shares In Reorganization)

The required PUC reduction on the redeemable preferred shares would be calculated as follows:

Increase In Legal Stated Capital		$440,000
Less The Excess, If Any, Of:		
PUC Of Common Shares	($400,000)	
Over The Non-Share Consideration	480,000	Nil
PUC Reduction		$440,000

This means that the redeemable preferred shares would have a PUC of nil ($440,000 - $440,000).

The adjusted cost base of the redeemable preferred shares would be calculated as follows:

Adjusted Cost Base Of Common Shares	$500,000
Non-Share Consideration	(480,000)
Adjusted Cost Base Of Redeemable Preferred Shares	$ 20,000

Because the non-share consideration was greater than the PUC of the old shares, the resulting ITA 84(3) deemed dividend and the capital loss would be calculated as follows:

PUC Of New Shares	Nil
Plus Non-Share Consideration	$480,000
Proceeds Of Redemption Under ITA 84(5)(d)	$480,000
PUC Of Old Shares	(400,000)
ITA 84(3) Deemed Dividend (Non-Eligible)	$ 80,000

Adjusted Cost Base Of New Shares	$ 20,000
Plus Non-Share Consideration	480,000
Proceeds Of Disposition Under ITA 86(1)(c)	$500,000
ITA 84(3) Deemed Dividend	(80,000)
Adjusted Proceeds	$420,000
Adjusted Cost Base Of Old Shares	(500,000)
Capital Gain (Loss)	($ 80,000)
Inclusion Rate	1/2
Allowable Capital Loss	($ 40,000)

The taxable non-eligible dividend would be $93,600 [(117%)($80,000)]. The taxable dividend would qualify for a federal dividend tax credit of $9,848 [(21/29)(17%)($80,000)].

Exam Exercise Solution Seventeen - 6 (Exchange Of Shares In Reorganization)

The required PUC reduction on the redeemable preferred shares would be calculated as follows:

Increase In Legal Stated Capital		$750,000
Less The Excess, If Any, Of:		
PUC Of Common Shares	($700,000)	
Over The Non-Share Consideration	700,000	Nil
PUC Reduction		$750,000

This means that the redeemable preferred shares would have a PUC of nil ($750,000 - $750,000).

The adjusted cost base of the redeemable preferred shares would be calculated as follows:

Adjusted Cost Base Of Common Shares	$400,000
Non-Share Consideration	(700,000)
Adjusted Cost Base Of Redeemable Preferred Shares	Nil

While there is no ITA 84(3) deemed dividend in this problem, there is a taxable capital gain. The relevant calculations are as follows:

PUC Of New Shares	Nil
Plus Non-Share Consideration	$700,000
Proceeds Of Redemption Under ITA 84(5)(d)	$700,000
PUC Of Old Shares	(700,000)
ITA 84(3) Deemed Dividend (Non-Eligible)	Nil

Adjusted Cost Base Of New Shares	$ Nil
Plus Non-Share Consideration	700,000
Proceeds Of Disposition Under ITA 86(1)(c)	$700,000
ITA 84(3) Deemed Dividend	Nil
Adjusted Proceeds	$700,000
Adjusted Cost Base Of Old Shares	(400,000)
Capital Gain	$300,000
Inclusion Rate	1/2
Taxable Capital Gain	$150,000

Exam Exercise Solution Seventeen - 7 (Gift To A Related Party)

Mr. Doyen gave up shares with a fair market value of $2,688,000 [(80%)($3,360,000)] in return for consideration of $2,310,000 ($630,000 + $1,680,000). As his son holds the remaining common shares, it would appear that there is a gift to the son of $378,000 ($2,688,000 - $2,310,000). This means that ITA 86(2) is applicable.

The PUC reduction on the new shares would be calculated as follows:

Increase In Legal Stated Capital		$1,680,000
Less The Excess Of:		
PUC Of Common Shares [(80%)($525,000)]	($420,000)	
Over The Non-Share Consideration	630,000	Nil
PUC Reduction		$1,680,000

This means that the redeemable preferred shares would have a PUC of nil ($1,680,000 - $1,680,000).

Under ITA 86(2)(e), the adjusted cost base of the redeemable preferred shares would be calculated as follows:

Adjusted Cost Base Of Mr. Doyen's Common Shares		$ 420,000
Deduct:		
Non-Share Consideration	($630,000)	
Gift	(378,000)	(1,008,000)
Adjusted Cost Base Of Preferred Shares		Nil

The calculation of the deemed dividend and capital gain would be as follows:

PUC Of New Shares	Nil
Plus Non-Share Consideration	$630,000
Proceeds Of Redemption Under ITA 84(5)(d)	$630,000
PUC Of Old Shares	(420,000)
ITA 84(3) Deemed Dividend (Non-Eligible)	$210,000

Proceeds Of Disposition Under ITA 86(2)(c) - Lesser Of:	
• Fair Market Value Of Shares Given Up [(80%)($3,360,000)]= $2,688,000	
• Non-Share Consideration Plus Gift ($630,000 + $378,000) = $1,008,000	$1,008,000
Less ITA 84(3) Deemed Dividend	(210,000)
Adjusted Proceeds	$ 798,000
Adjusted Cost Base Of Old Shares	(420,000)
Capital Gain	$ 378,000
Inclusion Rate	1/2
Taxable Capital Gain	$189,000

The taxable non-eligible dividend would be $245,700 [(117%)($210,000)]. The taxable dividend would qualify for a federal dividend tax credit of $25,852 [(21/29)(17%)($210,000)].

Exam Exercise Solution Seventeen - 8 (Gift To A Related Party)

Ms. Hutch gave up shares with a fair market value of $1,380,000 [(60%)($2,300,000)] in return for consideration of $1,180,000 ($350,000 + $830,000). As her common-law partner, Jane, holds the remaining common shares, it would appear that there is a gift to Jane of $200,000 ($1,380,000 - $1,180,000). This means that ITA 86(2) is applicable.

The PUC reduction on the new shares would be calculated as follows:

Increase In Legal Stated Capital		$830,000
Less The Excess Of:		
PUC Of Common Shares [(60%)($500,000)]	($300,000)	
Over The Non-Share Consideration	350,000	Nil
PUC Reduction		$830,000

This means that the redeemable preferred shares would have a PUC of nil ($830,000 - $830,000).

Under ITA 86(2)(e), the adjusted cost base of the redeemable preferred shares would be calculated as follows:

Adjusted Cost Base Of Ms. Hutch's Common Shares		$300,000
Deduct:		
Non-Share Consideration	($350,000)	
Gift	(200,000)	(550,000)
Adjusted Cost Base Of Preferred Shares		Nil

The calculation of the deemed dividend and capital gain would be as follows:

PUC Of New Shares	Nil
Plus Non-Share Consideration	$350,000
Proceeds Of Redemption Under ITA 84(5)(d)	$350,000
PUC Of Old Shares	(300,000)
ITA 84(3) Deemed Dividend (Non-Eligible)	$ 50,000

Proceeds Of Disposition Under ITA 86(2)(c) - Lesser Of:	
• Fair Market Value Of Shares Given Up [(60%)($2,300,000)]= $1,380,000	
• Non-Share Consideration Plus Gift ($350,000 + $200,000) = $550,000	$550,000
Less ITA 84(3) Deemed Dividend	(50,000)
Adjusted Proceeds	$500,000
Adjusted Cost Base Of Old Shares	(300,000)
Capital Gain	$200,000
Inclusion Rate	1/2
Taxable Capital Gain	$100,000

The taxable non-eligible dividend would be $58,500 [(117%)($50,000)]. The taxable dividend would qualify for a federal dividend tax credit of $6,155 [(21/29)(17%)($50,000)].

Exam Exercise Solution Seventeen - 9 (ITA 87 Amalgamation)

As Winner Ltd. has a clear majority of the shares in Combo Inc., it would appear that they have acquired control of Loser Inc. As the acquisition of control rules would be applicable, there would be a deemed year end for both Companies that coincides with the amalgamated year end. The non-capital loss carry forward of Loser Inc. will be flowed through to the amalgamated company, Combo Inc. However, because of the acquisition of control, the net capital loss cannot be used. In addition, for the non-capital loss to be used, Combo Inc. would have to continue the business in which the loss occurred. Further, the loss carry forward could only be applied against profits in that business.

Exam Exercise Solution Seventeen - 10 (ITA 87 Amalgamation)

As the shareholders of Core own a majority of the shares in Hubcore, there has been an acquisition of control and the acquisition of control rules would be applicable. This means that Hub's allowable capital loss cannot be carried forward after the acquisition of control. However, to the extent that Hubcore has profits in Hub's line of business, the non-capital loss carry forward can be deducted. This means that $52,000 of the $85,000 non-capital loss carry forward could be deducted by Hubcore, leaving a non-capital loss carry forward from 2016 of $33,000 ($85,000 - $52,000).

Exam Exercise Solution Seventeen - 11 (Winding-Up Of 90 Percent Subsidiary)

Under ITA 88(1), a limited bump-up in the value of non-depreciable assets is available. The basic limit would be calculated as follows:

Adjusted Cost Base Of Intell Inc. Shares	$1,800,000
Tax Values Of Intell Inc.'s Net Assets	
At Winding-Up ($750,000 - $112,500)	(637,500)
Dividends Paid By Intell Since Acquisition	Nil
Excess	$1,162,500

However, this basic amount cannot exceed the difference between the fair market value of the non-depreciable assets at the time of the share acquisition and their tax cost at that time. This amount would be $195,000 ($405,000 - $210,000). The bump-up in the Land value is limited to that amount, resulting in the following tax values for Intell's assets at the time of the ITA 88(1) winding-up:

Cash	$180,000
Land ($210,000 + $195,000)	405,000
Depreciable Assets - At UCC	360,000
Total Assets	$945,000

Exam Exercise Solution Seventeen - 12 (Winding-Up Of 90 Percent Subsidiary)

Under ITA 88(1), a limited bump-up in the value of non-depreciable assets is available. The basic limit would be calculated as follows:

Adjusted Cost Base of Columbia Inc. shares	$2,750,000
Tax Values Of Columbia Inc. Net Assets	
At Winding-Up	(2,200,000)
Dividends Paid By Columbia Inc. Since Acquisition	(300,000)
Excess	$ 250,000

The other limit is the excess of the fair market value of the non-depreciable assets at the time of acquisition and their tax cost at that time. This amount would be $350,000 ($750,000 - $400,000).

The bump-up would be $250,000, the lesser of these figures. This gives a value for the land of $650,000 ($400,000 + $250,000).

Exam Exercise Solution Seventeen - 13 (Winding-Up Of 90 Percent Subsidiary)

Under ITA 88(1), a limited bump-up in the value of non-depreciable assets is available. The basic limit would be calculated as follows:

Adjusted Cost Base of Island Inc. shares	$2,750,000
Tax Values Of Island Inc. Net Assets	
At Winding-Up	(2,200,000)
Dividends Paid By Island Inc. Since Acquisition	(300,000)
Excess	$ 250,000

However, this excess amount cannot exceed the difference between the fair market value of the non-depreciable assets at the time of the share acquisition and their tax cost at that time. This amount would be $150,000 ($350,000 - $200,000).

As a result, the ACB of the land would be equal to its original cost to Island Inc. of $200,000 plus the bump up of $150,000. The taxable capital gain is [(1/2)($1,600,000 - $350,000)] = $625,000.

Exam Exercise Solution Seventeen - 14 (Winding-Up Of A Canadian Corporation)

Given the size of the proceeds, the balance in the RDTOH account will clearly be less than one-third of the dividends to be declared. Given this, the required calculations are as follows:

Available Cash	$2,854,500
Dividend Refund (RDTOH Balance)	155,100
Total Distribution	$3,009,600
Paid Up Capital	(290,400)
ITA 84(2) Deemed Dividend	$2,719,200
Capital Dividend Account (Election Required)	(85,800)
Dividend Subject To Tax	$2,633,400

The remaining dividend subject to tax will qualify for the usual gross up and tax credit procedures for non-eligible dividends. The taxable dividend would be $3,081,078 [(117%)($2,633,400)] and the related federal dividend tax credit would be $324,181 [(21/29)(17%)($2,633,400)]. As a disposition of shares has occurred, we must also determine whether there is a capital gain or loss. The calculations are as follows:

Total Distribution To Shareholders	$3,009,600
ITA 84(2) Deemed Dividend	(2,719,200)
Deemed Proceeds Of Disposition	$ 290,400
Adjusted Cost Base Of Shares	(290,400)
Capital Gain	Nil

Exam Exercise Solution Seventeen - 15 (Winding-Up Of A Canadian Corporation)

Given the size of the proceeds, the balance in the RDTOH account will clearly be less than one-third of the dividends to be declared. Given this, the required calculations are as follows:

Available Cash	$700,000
Dividend Refund (RDTOH Balance)	20,000
Total Distribution	$720,000
Paid Up Capital	(1,000)
ITA 84(2) Deemed Dividend	$719,000
Capital Dividend	(100,000)
Dividend Subject To Tax	$619,000
Eligible Amount (GRIP Balance)	(30,000)
Non-Eligible Amount	$589,000

The eligible dividend would be grossed up to a taxable amount of $41,400 [(138%)($30,000)]. The related federal dividend tax credit would be $6,218 [($30,000(38%)(6/11)].

The non-eligible dividend would be grossed up to a taxable amount of $689,130 [(117%)($589,000)]. The related federal dividend tax credit would be $72,508 [(21/29)(17%)($589,000)].

TIF Solution Seventeen - 5A

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

A. 8

B. 5

C. 6

D. 3

E. 7

F. 10

G. 9

H. 2

The two unused definitions are as follows:

Exchange Of Shares In A Reorganization (ITA 86) = 4

Winding-Up Of A Canadian Corporation = 1

TIF Solution Seventeen - 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. 11 (not 7)

B. 8

C. 9

D. 4 (not 2)

E. 10

F. 14

G. 12 (not 5)

H. 3 (not 13)

The two unused definitions are as follows:

Exchange Of Shares In A Reorganization (ITA 86) = 6

Winding-Up Of A Canadian Corporation = 1

TIF Solution Seventeen - 6

Part A - ITA 85.1 Applies

Jerry elected to transfer his business using ITA 85(1) at a value of $986,000. Given that he took back non-share consideration of $500,000, the adjusted cost base of his Jerry's Flowers common shares would be calculated as follows:

Elected Value	$986,000
Non-Share Consideration	(500,000)
Adjusted Cost Base Of Common Shares	$486,000

The PUC of these shares would be calculated as follows:

Increase in Legal Stated Capital		$1,840,000
Less Excess, If Any, Of:		
Elected Value	($986,000)	
Non-Share Consideration	500,000	(486,000)
PUC Reduction		$1,354,000
PUC Of Common Shares ($1,840,000 - $1,354,000)		$ 486,000

Using these values for the Jerry's Flowers shares, if Jerry does not opt out of ITA 85.1, the tax consequences would be as follows:

- Jerry would be deemed to have disposed of his Jerry's Flowers shares at a value equal to their adjusted cost base of $486,000. Given this, there would be no capital gain on the disposition.
- Jerry would be deemed to have acquired his Large Flowers Inc. shares at a cost equal to the $486,000 adjusted cost base of his Jerry's Flowers shares.
- The PUC of the Large Flowers Inc. shares that have been issued to Jerry would be $486,000, the PUC of the Jerry's Flowers shares that were given up.

Part A - Opting Out Of ITA 85.1

The total fair market value of the Large Flowers shares is $3,750,000. In order to opt out of ITA 85.1, he will have to include a taxable capital gain of $1,632,000 [(1/2)($3,750,000 - $486,000)] in his 2016 tax return. This has the advantage of absorbing his $800,000 net capital loss carry forward. However, it will result in his being required to pay taxes on the remaining $832,000 ($1,632,000 - $800,000). Because all of his shares are involved in the exchange, he has no choice as to the amount of the gain to be recognized.

Part B - ACB For Large Flowers Inc.

The adjusted cost base of the Jerry's Flowers shares in the hands of Large Flowers Inc. would be the lesser of their $3,750,000 fair market value and their PUC. In this case, the PUC amount of $486,000 is lower and will be the adjusted cost base amount.

Part C - Alternative Solutions

There are two possible solutions that would make full use of the $800,000 net capital loss carry forward and minimize the current payment of taxes.

Alternative One Jerry could use ITA 85(1) to exchange the shares at an elected value of $2,086,000. If this value was elected, the resulting taxable capital gain would be equal to the required amount of $800,000 [(1/2)($2,086,000 - $486,000)]. Note that this would leave the adjusted cost base of the acquired shares at the elected value of $2,086,000. This compares to $486,000 if ITA 85.1 is used.

Alternative Two Each share of Jerry's Flowers Ltd. has a fair market value of $3,750 ($3,750,000 ÷ 1,000) and an adjusted cost base of $486 ($486,000 ÷ 1,000). This means that each share that is sold to Large Flowers would generate a taxable capital gain of $1,632 [(1/2)($3,750 - $486)]. Given this, selling 490 of these shares to Large Flowers would result in a taxable capital gain of $799,680 [(490)($1,632)]. This would be eliminated by the application of the $800,000 net capital loss carry forward. The remaining 510 (1,000 - 490) shares of Jerry's Flowers could then be exchanged for Large Flowers Inc. shares on a tax free basis under either of ITA 85(1) or ITA 85.1.

TIF Solution Seventeen - 7

The fair market value of the business is $12,013,000 , which is composed of tangible assets of $11,625,000, plus goodwill of $1,500,000, less the bank loan of $1,112,000.

The "exchange of shares in a reorganization" that Ms. Farrow referred to is provided for under ITA 86(1). In order to implement this rollover and achieve Ms. Farrow's goals, Woody should invest $5,000 in exchange for new common shares in Farrow Ltd.

At this point, Ms. Farrow can exchange, on a tax free basis, her existing common shares for new preferred shares with a redemption value of $12,013,000. In order for Ms. Farrow to retain control of Farrow Ltd., the preferred shares should be voting shares.

Under ITA 86(1), this exchange would have no immediate tax consequences. After this exchange, the adjusted cost base and PUC of the new preferred shares would be calculated as follows:

Adjusted Cost Base Of Shares Given Up	$600,000
Less: Non-Share Consideration	Nil
Adjusted Cost Base Of Preferred Shares	$600,000

Legal Stated Capital - Preferred Shares		$12,013,000
Less Excess, If Any, Of:		
PUC - Shares Given Up	($600,000)	
Non-Share Consideration	Nil	(600,000)
Required PUC Reduction		$11,413,000
PUC - Preferred Shares ($12,013,000 - $11,413,000)		$600,000

Ms. Farrow's preferred shares will not participate in the future growth of the Farrow Ltd. This means that all of the future growth in this company will accrue to her son Woody who is holding the only common shares in the Company.

Subsequent to these transactions, the August 1, 2016 Balance Sheet would be as follows:

Farrow Ltd.
Shareholders' Equity
As At August 1, 2016

Tangible Assets At Tax Values ($11,625,000 + $5,000)	$11,630,000
Bank Loan	$ 1,112,000
Preferred Shares (Paid Up Capital)	600,000
Common Shares	5,000
Retained Earnings	9,913,000
Total	$11,630,000

Note that Ms. Farrow's potential capital gain of $11,413,000 ($12,013,000 - $600,000) has not disappeared. If her preferred shares are sold for the fair market value of $12,013,000, with the adjusted cost base of the shares being $600,000, there would be a capital gain of $11,413,000. Alternatively, if the preferred shares are redeemed, their PUC is $600,000, which would result in an ITA 84(3) deemed dividend of $11,413,000 (there is no capital gain in this solution). The procedure described above will simply defer the potential gain until the new preferred shares are sold or redeemed.

TIF Solution Seventeen - 8

Part A (Rollover To Corporation)

The adjusted cost base of the common shares issued on January 1, 2011 would be calculated as follows:

Elected Value	$1,373,000
Non-Share Consideration	(1,000,000)
Adjusted Cost Base Of Common Shares	$ 373,000

The PUC of these shares would be calculated as follows:

Legal Stated Capital		$650,000
Excess Of, If Any, Of		
Total Elected Value	($1,373,000)	
Over Non-Share Consideration	1,000,000	(373,000)
Required PUC Reduction		$277,000
PUC Of Common Shares ($650,000 - $277,000)		$373,000

Part A (Share-For-Share Exchange)

The adjusted cost base of the preferred shares would be calculated as follows:

Adjusted Cost Base Of Shares Given Up	$373,000
Non-Share Consideration	(906,000)
Adjusted Cost Base Of Preferred Shares	Nil

The PUC of the preferred shares would be calculated as follows:

Legal Stated Capital		$5,500,000
Excess, If Any, Of		
PUC Of Shares Given Up	($373,000)	
Over Non-Share Consideration	906,000	Nil
Required PUC Reduction		$5,500,000
PUC Of Preferred Shares ($5,500,000 - $5,500,000)		Nil

The ITA 84(3) deemed dividend would be calculated as follows:

PUC Of Preferred Shares	$ Nil
Non-Share Consideration	906,000
Proceeds Of Redemption	$906,000
PUC Of Shares Given Up	(373,000)
ITA 84(3) Deemed Dividend	$533,000

As a result of the share-for-share exchange, the amount to be included in Marian's Net Income For Tax Purposes would be the grossed up dividend of $623,610 [(117%)($533,000)]. In addition, there would be a federal dividend tax credit of $65,614 [(21/29)(17%)($533,000)].

The exchange would not result in a capital gain as shown in the following calculation:

Adjusted Cost Base Of Preferred Shares	$ Nil
Non-Share Consideration	906,000
Proceeds Of Disposition	$906,000
ITA 84(3) Deemed Dividend	(533,000)
Adjusted Proceeds Of Disposition	$373,000
Adjusted Cost Base Of Shares Given Up	(373,000)
Capital Gain	Nil

Part B

The results of having Home Software Inc. redeem her preferred shares would be as follows:

Proceeds Of Redemption	$5,500,000
PUC Of Preferred Shares	Nil
ITA 84(3) Deemed Dividend (Non-Eligible)	$5,500,000

As a result of the redemption, the amount to be included in Marian's Net Income For Tax Purposes would be the grossed up dividend of $6,435,000 [(117%)($5,500,000)]. In addition, there would be a federal dividend tax credit of $677,069 [(21/29)(17%)($5,500,000)].

As was the case with the share-for-share exchange, where will be no capital gain on the redemption:

Proceeds Of Disposition	$5,500,000
ITA 84(3) Deemed Dividend	(5,500,000)
Adjusted Proceeds Of Disposition	Nil
Adjusted Cost Base Of Preferred Shares	Nil
Capital Gain	Nil

TIF Solution Seventeen - 9

Part A

Gift To James Derek owns 80 percent (12,000 ÷ 15,000) of the Nome Industries shares. His gift to James would be calculated as follows:

Fair Market Value Of Old Common Shares		
[(80%)($1,500,000)]		$1,200,000
Fair Market Value Of Consideration:		
Non-Share Consideration	($200,000)	
Preferred Shares (Fair Market Value)	(800,000)	(1,000,000)
Gift		$ 200,000

It is fair to assume that this amount is a gift to James, as he is the only other holder of common shares in Nome Ltd.

PUC Of New Preferred Shares The PUC reduction required under ITA 86(2.1) would be calculated as follows:

Legal Stated Capital Of New Shares		$800,000
Less The Excess, If Any, Of:		
PUC Of Old Shares [(12,000)($60)]	($720,000)	
Over The Non-Share Consideration	200,000	(520,000)
PUC Reduction		$280,000
PUC Of Preferred Shares ($800,000 - $280,000)		$520,000

Adjusted Cost Base Of New Preferred Shares This amount would be calculated as follows:

Adjusted Cost Base Of Old Shares [(12,000)($85)]		$1,020,000
Deduct:		
Non-Share Consideration	($200,000)	
Gift	(200,000)	(400,000)
Adjusted Cost Base Of New Shares		$ 620,000

ITA 84(3) Dividend For the purposes of determining any ITA 84(3) deemed dividend on the redemption of the old shares, the proceeds of redemption would be as follows:

PUC Of New Preferred Shares	$520,000
Non-Share Consideration	200,000
Proceeds Of Redemption	$720,000

As shown in the following calculation, there would be no ITA 84(3) dividend:

Proceeds Of Redemption	$720,000
PUC Of Old Shares	(720,000)
ITA 84(3) Dividend	Nil

Capital Loss For the purposes of determining any capital gain or loss on the redemption of the old common shares, the proceeds of disposition would be the lesser of the $1,200,000 fair market value of the old common shares and the following amount:

Non-Share Consideration	$200,000
Gift	200,000
Proceeds Of Disposition	$400,000

As shown in the following calculation, there would be a capital loss:

Proceeds Of Disposition	$ 400,000
ITA 84(3) Deemed Dividend	Nil
Adjusted Proceeds Of Disposition	$ 400,000
Adjusted Cost Base Of Old Shares	(1,020,000)
Capital Gain (Loss)	($ 620,000)

This capital loss would be disallowed by ITA 86(2)(d), resulting in no immediate tax consequences for Derek Blume.

Part B

This transaction will not alter the total fair market value of the Company. However, the value of the common shares will increase by the $200,000 amount of the gift. There will be no corresponding increase in the amount of the tax cost of these shares and, as a consequence, this value will be taxed when James sells the common shares or they are redeemed. As this value will also be taxed in the hands of Derek Blume, there will be double taxation on this $200,000 amount.

Part C

If Derek's preferred shares were redeemed at their fair market value of $800,000, the tax consequences would be as follows:

Redemption Proceeds	$800,000
PUC	(520,000)
ITA 84(3) Deemed Dividend (Non-Eligible)	$280,000

The gross up amount of the dividend will be $327,600 [(117%)($280,000)]. It will generate a federal dividend tax credit of $34,469 [(21/29)(17%)($280,000)].

Redemption Proceeds	$800,000
Deemed ITA 84(3) Dividend	(280,000)
Adjusted Proceeds Of Disposition	$520,000
Adjusted Cost Base	(620,000)
Capital Loss	($100,000)

If Derek had simply sold his shares, there would have been a capital gain of $180,000 ($1,200,000 - $1,020,000). The net result of this redemption is the same $180,000 ($280,000 in dividends - $100,000 capital loss). However, as noted in Part B, his son James will be paying taxes on an additional $200,000 capital gain because of the increased fair market value of his shares which results from the gift.

A further problem is the form of the income. On the straight sale of shares, the $180,000 would have been a capital gain, only one-half of which would be taxable. The inappropriate use of ITA 86 has resulted in a $280,000 dividend which will be taxed at higher rates, offset by a $100,000 capital loss which is only one-half deductible. Although capital losses can generally be deducted only to the extent of available capital gains, if Derek's cancer treatment is unsuccessful, the capital loss will be deductible against other income in the year of death or the immediately preceding year.

Although the special rule for capital losses at death is tax advantageous, it is unlikely that Derek would want to be in the position to take advantage of it.

TIF Solution Seventeen - 10

Part A - Gift Calculation

The fair market value of the common shares exchanged was $2,625,000 [(75%)($3,500,000)]. As this amount is equal to the $2,625,000 ($2,000,000 + $625,000) total of cash and preferred shares received, there is no gift to a related party.

Part B - PUC Of Preferred Shares

Since Mr. Martinez purchased the shares directly from Ms. Cruz, the paid up capital of the common shares remains at $465,000. The PUC of the preferred shares would be calculated as follows:

Increase In Legal Stated Capital		$2,000,000
Less The Excess, If Any, Of:		
PUC Of Common Shares		
[(75%)($465,000)]	($348,750)	
Over The Non-Share Consideration	625,000	Nil
PUC Reduction		$2,000,000

PUC Of Preferred Shares ($2,000,000 - $2,000,000)	Nil

Part C - Adjusted Cost Base Of Preferred Shares

The adjusted cost base of the preferred shares would be calculated as follows:

Adjusted Cost Base Of Common Shares [(75%)($1,340,000)]	$1,005,000
Non-Share Consideration	(625,000)
Adjusted Cost Base Of Preferred Shares	$ 380,000

Part D - Proceeds Of Redemption And Disposition For Common Shares

The Proceeds Of Redemption would be calculated as follows:

Non-Share Consideration	$625,000
PUC Of Preferred Shares	Nil
Proceeds Of Redemption [ITA 84(5)(d)]	$625,000

The Proceeds Of Disposition would be calculated as follows:

Adjusted Cost Base Of Preferred Shares	$ 380,000
Non-Share Consideration	625,000
Proceeds Of Disposition [ITA 86(1)(c)]	$1,005,000

Part E - Tax Consequences Of Sale And Exchange Of Shares

The sale of shares to his daughter would result in a taxable capital gain calculated as follows:

Proceeds Of Disposition	$875,000
Adjusted Cost Base [(25%)($1,340,000)]	(335,000)
Capital Gain	$540,000
Inclusion Rate	1/2
Taxable Capital Gain	$270,000

The exchange of shares would have tax consequences as follows:

Proceeds Of Redemption	$625,000
PUC Of Common Shares [(75%)($465,000)]	(348,750)
ITA 84(3) Deemed Dividend (Non-Eligible)	$276,250

Proceeds Of Disposition	$1,005,000
ITA 84(3) Deemed Dividend	(276,250)
Adjusted Proceeds Of Disposition	$ 728,750
Adjusted Cost Base Of Common Shares [(75%)($1,340,000)]	(1,005,000)
Capital Loss	($ 276,250)
Inclusion Rate	1/2
Allowable Capital Loss	($ 138,125)

The overall tax consequences of the sale to his daughter and exchange of shares would be as follows:

Taxable Dividend [($276,250)(117%)]	$323,213
Net Taxable Capital Gain ($270,000 - $138,125)	131,875
Income Inclusion	$455,088

The deemed non-eligible dividend would qualify for a federal dividend tax credit of $34,007 [(21/29)(17%)($276,250)].

Part F - Tax Consequences Of Preferred Share Redemption

The tax consequences of the immediate redemption of the preferred shares would be as follows:

Proceeds Of Redemption	$2,000,000
PUC Of Preferred Shares	Nil
ITA 84(3) Deemed Dividend	$2,000,000

Proceeds Of Disposition	$2,000,000
ITA 84(3) Deemed Dividend	(2,000,000)
Adjusted Proceeds Of Disposition	Nil
Adjusted Cost Base Of Preferred Shares	(380,000)
Capital Loss	($ 380,000)
Inclusion Rate	1/2
Allowable Capital Loss	($ 190,000)

Assuming Mr. Martinez has no other taxable capital gains in the year, there is a net capital loss carry over of $58,125 ($270,000 - $138,125 - $190,000).

TIF Solution Seventeen - 11

Part A - Funds Available For Distribution

The taxable capital gains and active business income (recapture) at the corporate level can be calculated as follows:

Asset	Taxable Capital Gains	Active Business Income
Inventories	Nil	Nil
Taxable Capital Gains:		
On Land [(1/2)($2,600,000 - $942,450)]	$ 828,775	Nil
On Building [(1/2)($1,846,000 - $1,160,000)]	343,000	
Recapture On Building ($1,160,000 - $723,640)		$436,360
Totals	$1,171,775	$436,360

As the active business income is less than the $500,000 annual business limit, there will be no addition to the General Rate Income Pool Balance. The taxable capital gains are not eligible for addition to the GRIP balance.

Taxable Income will be $1,608,135 ($1,171,775 + $436,360). Tax Payable on this amount will be calculated as follows:

Federal Tax On Investment Income [(28% + 10-2/3%)($1,171,775)]	$453,086
Federal Tax On Business Income [(10.5%)($436,360)]	45,818
Federal Part I Tax Payable	$498,904
Provincial Tax On Investment Income [(14%)($1,171,775)]	164,049
Provincial Tax On Business Income [(3%)($436,360)]	13,091
Total Tax Payable	$676,044

The balance in the RDTOH is calculated as follows:

Balance Prior To Asset Dispositions	$ 32,345
Addition - The Least Of:	
• [(30-2/3%)($1,171,775)] = $359,344	
• [(30-2/3%)($1,608,135 - $436,360)] = $359,344	
• Federal Part I Tax Payable = $498,904	359,344
Ending RDTOH	$391,689

The amount available for distribution to Mr. Korngold, after the payment of the liabilities and the taxes at the corporate level, can be calculated as follows:

Fair Market Values:	
Inventories	$ 48,650
Land	2,600,000
Building	1,846,000
Gross Proceeds	$4,494,650
Liabilities	(313,260)
Tax Payable	(676,044)
Dividend Refund (Note)	344,818
Funds Available For Distribution	$3,850,164

Note The dividend refund is equal to the balance in the RDTOH account. As will be shown in a subsequent calculation, the taxable dividends paid on the winding-up will be well in excess of the amount required to use the full balance in the RDTOH account.

With respect to the capital dividend account, the final balance is calculated as follows:

Balance Before Dispositions	$ 326,470
Disposition Of Land	828,775
Disposition Of Building	343,000
Ending Balance	$1,498,245

Part B - Components Of Distribution

Assuming an election has been made to declare the maximum capital dividend, the taxable dividend component of the total distribution to Mr. Korngold can be calculated as follows:

Distribution To Mr. Korngold	$3,850,164
Paid Up Capital	(625,000)
ITA 84(2) Deemed Dividend	$3,225,164
Capital Dividend (Balance In Account)	(1,498,245)
Deemed Dividend Subject To Tax (Non-Eligible)	$1,726,919

As Korngold has no GRIP balance, all of this dividend will be non-eligible. The taxable amount will be $2,020,495 [(117%)($1,726,919)]. This dividend will qualify for a federal dividend tax credit of $215,590 [(21/29)(17%)($1,726,919]

Part B - Capital Gain

With respect to capital gains, ITA 54 indicates that the proceeds of disposition for purposes of determining any capital gain on the disposition of shares does not include any amount paid out as ITA 84(2) dividends. Given the preceding calculation, the capital gain to Mr. Korngold would be calculated as follows:

Actual Distribution To Mr. Korngold	$3,850,164
ITA 84(2) Deemed Dividend	(3,225,164)
Deemed Proceeds Of Disposition	$ 625,000
Adjusted Cost Base For Shares	(625,000)
Capital Gain	Nil

TIF Solution Seventeen - 12

Part A - After Tax Funds At Corporate Level

Taxable Income And Tax Payable

Tax Payable resulting from the sale of assets can be calculated as follows:

	Active Business Income	Taxable Capital Gains
Accounts Receivable ($195,000 - $215,000)	($20,000)	Nil
Land [(1/2)($193,875 - $132,000)]	Nil	$30,938
Recapture On Building ($550,000 - $492,000)	58,000	Nil
Goodwill [($56,250 - Nil)(1/2)]	28,125	Nil
Totals	$66,125	$30,938

Total Taxable Income would be $97,063 ($66,125 + $30,938). The Tax Payable on this amount would be calculated as follows:

Federal Tax On Business Income [(10.5%)($66,125)]	$ 6,943
Federal Tax On Investment Income [(28% + 10-2/3%)($30,938)]	11,963
Part I Tax Payable	$18,906
Provincial Tax On Business Income [(3%)($66,125)]	1,984
Provincial Tax On Investment Income [(13%)($30,938)]	4,022
Total Tax Payable	$24,912

Capital Dividend Account

The balance in the capital dividend account would be calculated as follows:

Opening Balance	$ 63,000
Addition From Sale Of Land	30,938
Addition From Sale Of Goodwill	28,125
Closing Balance	$122,063

RDTOH Balance

The balance in the RDTOH account would be calculated as follows:

Opening Balance	$31,000
Add: Least Of:	
• 30-2/3% Of Investment Income [(30-2/3%)($30,938)] = $9,488	
• 30-2/3% Of Taxable Income, Less Amount Eligible For Small Business Deduction [(30-2/3%)($97,063 - $66,125)] = $9,488	
• Part I Tax Payable = $18,906	9,488
Closing Balance	$40,488

Funds Available For Distribution

Given the preceding calculation, the after tax funds available for distribution would be calculated as follows:

Purchase Price, Plus Cash ($984,000 + $50,000)	$1,034,000
Corporate Tax Payable	(24,912)
Balance Before Dividend Refund	$1,009,088
Dividend Refund (RDTOH Balance)	40,488
After Tax Distribution	$1,049,576

The dividend refund is equal to the balance in the RDTOH account. As will be shown in a subsequent calculation, the taxable dividends paid on the winding-up will be well in excess of the amount required to use the full balance in the RDTOH account.

Part B - After Tax Retention By Mr. Pellerin

Taxable Dividend

Assuming an election has been made to declare the maximum capital dividend, the taxable dividend component of the distribution can be analyzed as follows:

Total Distribution	$1,049,576
Paid Up Capital	(600,000)
ITA 84(2) Deemed Dividend	$ 449,576
Capital Dividend (Balance In Account)	(122,063)
Deemed Dividend Subject To Tax (Non-Eligible)	$ 327,513

For capital gains purposes, the redemption of shares that occurred as part of the winding-up would not have any tax effect. This is demonstrated by the following calculation:

Proceeds Of Redemption	$1,049,576
ITA 84(2) Deemed Dividend	(449,576)
Proceeds Of Disposition Under ITA 54	$ 600,000
Adjusted Cost Base	(600,000)
Capital Gain	Nil

Personal Tax Payable

The PUC amount, as well as the capital dividend, would be received by Mr. Pellerin on a tax free basis. Tax Payable on the deemed non-eligible dividend would be calculated as follows:

Deemed Dividend Subject To Tax	$327,513
Gross Up Of 17 Percent	55,677
Taxable Dividend	$383,190
Personal Tax Rate (33% + 16%)	49%
Tax Before Dividend Tax Credit	$187,763
Dividend Tax Credit [(21/29 + 8/29)($55,677)]	(55,677)
Personal Tax Payable	$132,086

After Tax Retention

Given the preceding calculations, the after tax cash available to Mr. Pellerin would be calculated as follows:

Total Distribution	$1,049,576
Personal Tax Payable	(132,086)
After Tax Cash Retained	$ 917,490

TIF Solution Seventeen - 13

Sale Of Assets

This calculation requires two steps. First, we must determine the after tax proceeds that will be available at the corporate level subsequent to the sale of the assets. Then, a second stage analysis is required to determine the amount that will be retained by Mr. Carson after he pays all of the taxes that are due on the proceeds that are distributed to him.

Calculation Of Corporate Income On Asset Dispositions

Net Income For Tax Purposes on the disposition of assets would be as follows:

Asset	Active Business Income (Loss)	Taxable Capital Gains
Accounts Receivable (Note 1)	($ 33,750)	
Inventories ($976,000 - $869,750)	106,250	
Land [(1/2)($405,000 - $201,500)]		$101,750
Building:		
($1,281,000 - $469,250)	811,750	
[(1/2)($2,061,000 - $1,281,000)]		390,000
Terminal Loss On Equipment ($294,000 - $171,250)	(122,750)	
Goodwill [(3/4)($811,000)(1/2 ÷ 3/4)]	405,500	
Taxable Amounts	$1,167,000	$491,750

Note 1 The loss on the Accounts Receivable is a business loss because the ITA 22 election was made. The amount of the loss is the tax value of $406,000, less the fair market value of $372,250.

Taxable Income And Tax Payable

Based on the preceding analysis, Carson Enterprises Ltd. would have Taxable Income calculated as follows:

Net Income For Tax Purposes ($1,167,000 + $491,750)	$1,658,750
Non-Capital Loss Carry Forward	(83,000)
Net Capital Loss Carry Forward	(129,650)
Taxable Income From Sale Of Assets	$1,446,100

Basic Federal Tax [(38%)($1,446,100)]	$549,518
Federal Tax Abatement [(10%)($1,446,100)]	(144,610)
Small Business Deduction (Note 2)	(87,500)
ART (Note 3)	38,624
General Rate Reduction [(13%)($1,446,100 - $500,000 - $362,100)]	(75,920)
Part I Tax Payable	$280,112
Provincial Taxes:	
[(3%)($500,000)]	15,000
[(14%)($1,446,100 - $500,000)]	132,454
Corporate Tax Payable	$427,566

Note 2 The small business deduction is equal to 17.5 percent of the least of:

• Active Business Income	$1,167,000
• Taxable Income	$1,446,100
• Annual Business Limit	$500,000

The small business deduction is equal to $87,500 [(17.5%)($500,000)].

Note 3 Aggregate Investment Income is calculated as follows:

Taxable Capital Gains	$491,750
Net Capital Loss Deducted	(129,650)
Aggregate Investment Income	$362,100

ART is equal to 10-2/3% of the lesser of:

- Aggregate Income = $362,100
- Taxable Income Less The Amount Eligible For The Small Business Deduction = $946,100 ($1,446,100 - $500,000)

ART is equal to $38,624 [(10-2/3%)($362,100)].

GRIP Balance

The GRIP balance can be calculated as follows:

Taxable Income	$1,446,100
Amount Eligible For The Small Business Deduction	(500,000)
Aggregate Investment Income	(362,100)
Subtotal	$ 584,000
Rate	72%
GRIP Balance	$ 420,480

RDTOH Balance

As there is no opening balance in the RDTOH, the closing balance would be equal to the addition for the year. This addition would be the least of:

• 30-2/3 Percent Of Investment Income [(30-2/3%)($362,100)]	$111,044
• 30-2/3 Percent Of Taxable Income, Less The Amount Eligible For The Small Business Deduction [(30-2/3%)($1,446,100 - $500,000)]	$290,137
• Part I Tax Payable	$280,112

The least of these three figures and the balance in the RDTOH account is $111,044.

Funds Available For Distribution

The funds available for distribution would be calculated as follows:

Total Fair Market Value Of Assets (From Statement)	$4,851,000
Current Liabilities Assumed	(697,000)
Loan From Shareholder Assumed	(137,500)
Proceeds Of Disposition	$4,016,500
Corporate Tax Payable	(427,566)
Dividend Refund (Balance In RDTOH)	111,044
Funds Available For Distribution	$3,699,978

Capital Dividend Account Balance

The balance in the capital dividend account would be calculated as follows:

Opening Balance	$ 164,500
Non-Taxable One-Half Of Capital Gains	491,750
Addition From Goodwill Disposition [($811,000)(1/2)]	405,500
Closing Balance	$1,061,750

Taxable Dividends Resulting From Distribution

Assuming an election has been made to declare the maximum capital dividend and the maximum eligible dividend, the taxable dividend component of the total distribution to Mr. Carson can be calculated as follows:

Funds Available For Distribution	$3,699,978
Paid Up Capital	(265,000)
ITA 84(2) Deemed Dividend	$3,434,978
ITA 83(2) Capital Dividend (Balance In Account)	(1,061,750)
Deemed Dividend Subject To Tax	$2,373,228
Eligible Dividend (Must Be Designated As Such)	(420,480)
Non-Eligible Dividend (Remainder)	$1,952,748

As shown in the following calculation, Mr. Carson will not have a capital gain on the disposition of his shares:

Amount Distributed	$3,699,978
ITA 84(2) Deemed Dividend	(3,434,978)
Deemed Proceeds Of Disposition	$ 265,000
Adjusted Cost Base Of Shares	(265,000)
Capital Gain	Nil

Personal Tax Payable

As there is no capital gain and the capital dividend is received tax free, the personal Tax Payable on the dividend subject to tax would be calculated as follows:

Eligible Dividends	$ 420,480
Gross Up Of 38 Percent	159,782
Non-Eligible Dividends	1,952,748
Gross Up Of 17 Percent	331,967
Taxable Amount Of Dividends	$2,864,977
Combined Tax Rate (33% + 18%)	51%
Tax Payable Before Dividend Tax Credit	$1,461,138
Dividend Tax Credits:	
Eligible Dividends [(6/11 + 5/11)($159,782)]	(159,782)
Non-Eligible Dividends [(21/29 + 8/29)($331,967)]	(331,967)
Personal Tax Payable	$ 969,389

Sale Of Shares

This relatively simple calculation is as follows:

Proceeds From The Sale Of Shares	$3,508,000
Adjusted Cost Base	(265,000)
Capital Gain	$3,243,000
Inclusion Rate	1/2
Taxable Capital Gain	$1,621,500
Tax Rate (33% + 18%)	51%
Tax Payable	$ 826,965

Conclusion

The after tax proceeds from the two alternative dispositions can be calculated as follows:

	Sale Of Shares	Sale Of Assets
Proceeds Available	$3,508,000	$3,699,978
Personal Tax Payable	(826,965)	(969,389)
After Tax Retention	$2,681,035	$2,730,589

The conclusion is very clear. The cash retained from the sale of assets and distribution of proceeds is $49,554 ($2,730,589 - $2,681,035) larger than the cash retained from selling the shares. Note, however, that if Mr. Carson could convert Carson Enterprises to a qualified small business corporation and fully use his lifetime capital gains deduction, this result would be altered in favour of selling shares.

The full $3,699,978 could be left in the business for further operations as an investment company. Given the current rate of taxation on the investment income of corporations, it is not likely that this would be an attractive alternative.

Chapter Eighteen Test Item File Solutions

TIF Solution Eighteen - 1

1. There is a deeming rule applicable to partnerships that requires that it calculate business income, property income, and capital gains as if it was a person resident in Canada. Once these amounts are determined, they are allocated on a source-by-source basis to the members of the partnership as per the terms of the partnership agreement. As the partners are taxable entities (e.g., individuals, corporations, or trusts) the allocated amounts will be included in their Net Income For Tax Purposes.

2. The three elements are:

    1. There must be two or more persons (taxable entities) involved.
    2. These persons must be carrying on a business.
    3. The business must be carried on with a view to making a profit.

3. The points that could be listed here include:

    - the initial and ongoing partner contributions and ownership percentage of each partner,
    - the responsibilities of each partner and the division of work between the partners,
    - how income and drawings will be allocated and how much compensation is to be paid,
    - signing authority on the partnership bank accounts and required approval for purchases,
    - procedures for bringing in new partners, and
    - procedures to deal with the withdrawal or death of a partner, or the sale of the business.

4. The descriptions of the three basic types of partnerships are as follows:

    General Partnership In a general partnership, all partners have unlimited liability for partnership debts.

    Limited Partnership A limited partnership has at least one general partner who has unlimited liability for the debts of the partnership. Other partners, referred to as limited partners, are only responsible to the extent of their actual and promised contributions to the partnership.

    Limited Liability Partnership Members of limited liability partnerships have unlimited liability for most types of partnership debt. There is, however, an important exception. Members of limited liability partnerships are not personally liable for obligations arising from the wrongful or negligent action of:

    - their professional partners; or
    - the employees, agents or representatives of the partnership who are conducting partnership business.

5. Factors that could be listed here include:

    - co-venturers contractually do not have the power to bind other co-venturers;
    - co-venturers retain ownership of property contributed to the undertaking;
    - co-venturers are not jointly and severally liable for debt of the undertaking;
    - co-venturers share gross revenues, not profits; and
    - while partnerships may be formed for the same purpose as a joint venture, they are usually of longer duration and involve more than a single undertaking.

6. The basic difference is that, if an arrangement is considered to be a joint venture rather than a partnership, there will be no separate calculation of income at the organization level. Each participant in the joint venture will make their own calculation of income. In contrast, a partnership must make a separate calculation of Net Income For Tax Purposes and this figure must be used by all of the partners.

7. The general rules are as follows:

   - If any member of the partnership is an individual or a professional corporation, the partnership must have a December 31 year end.
   - Otherwise, any fiscal period can be used as long as it does not end more than 12 months after it begins.

   There is an exception to the calendar year requirement that allows the use of a non-calendar fiscal year in situations where all of the partnership members are individuals and an election is filed prior to the end of the partnership's first fiscal year.

8. In the absence of a special rule, partnerships could not deduct CCA. However, the *Income Tax Act* provides a special provision. For purposes of determining income, a partnership is considered to own the property of the partnership.

9. Partnership income may include business income, property income (interest, dividends, rents), and/or capital gains. These amounts will be allocated to the partners as the same types of income. This means that they will retain the tax rules associated with these types of income. For example:

   - When partnership dividends are allocated to partners who are individuals, the allocated amounts will be subject to the usual gross up and tax credit procedures.
   - When partnership capital gains are allocated to partners, only one-half the allocated amount will be taxable.

10. The CRA does not permit the deduction of salaries to partners in the determination of Net Business Income at the partnership level. As they are deducted in the determination of accounting Net Income, they are added back to accounting Net Income to arrive at Net Business Income. Any salary paid to a partner is considered a priority allocation of Net Business Income to that specific partner.

11. Whether an adjustment is needed depends on the accounting procedures used. As GAAP for partnerships does not deal with drawings, such amounts may or may not have been deducted in the accounting statements. If there were deducted in the accounting statements, they will need to be added back in the calculation of business income for tax purposes. Alternatively, if they have not been deducted in the accounting statements, no adjustment is required.

12. Charitable donations cannot be deducted in the determination of Net Business Income at the partnership level. As they are usually deducted in the determination of accounting Net Income, they must be added back to this figure to determine the partnership's Net Business Income. While the question does not require this information, these amounts will be allocated to the partners to be used either as a deduction (corporations) or as a basis for a tax credit (individuals).

13. The tax rules require that CCA be deducted at the partnership level. For no CCA to be deducted in determining an individual partner's income, no CCA can be deducted at the partnership level. This means that the other partners should only agree to this request if they are willing to have their partnership income increased by having no CCA deducted at the partnership level. They may or may not be willing to agree to this.

14. Accounting net income will include gains on the sale of capital assets as calculated under GAAP. These amounts will be deducted in determining the net business income of the partnership. They will not, however, be replaced by the taxable capital gains. These latter amounts are not part of the partnership's net business income. They will be subject to a separate allocation to the individual partners in order to retain their tax characteristics.

15. In the absence of a provision in the partnership agreement, partnership law will require that profits be shared in equal fixed ratios.

16. There are two ways the interest can be acquired:

    - The interest can be acquired directly from a current partner or partners by purchasing all or part of their interest.
    - The interest can be acquired directly from the partnership by transferring assets to this organization.

17. The treatment of each of the items is as follows:

    Capital Contributions Capital contributions are added to the adjusted cost base of the partnership interest in the period in which they are made.

    Partner's Share Of Partnership Net Business Income Each partner's share of partnership Net Business Income is added to the partner's adjusted cost base on the first day of the year following the year in which the income was earned by the partnership.

    Partner's Drawings Partner's drawings are deducted from the adjusted cost base of the partnership interest in the year in which they are made.

18. One-half of a partner's share of the partnership's capital gains (i.e., the partner's share of the net taxable capital gains) will be included in his Net Income For Tax Purposes in the year in which the gains are realized. The partner's share of the partnership's capital gains (i.e. 100 percent) will be added to the adjusted cost base of his partnership interest on the first day of the following taxation year.

19. The partner's share of the partnership dividends will be included in his Net Income For Tax Purposes in the year in which the dividends are received by the partnership. The partner will gross up the allocated amount and be entitled to a dividend credit against Tax Payable. The partner's share of the partnership dividends will be added to the adjusted cost base of his partnership interest on the first day of the following taxation year. This amount will not include the gross up.

20. For most capital assets, the negative amount will have to be included in income and added back to the adjusted cost base of the asset. However, for partnership interests, the *Income Tax Act* makes an exception. As a consequence, as long as the partner is an active general partner, the amount does not have to be included in income unless there is a disposal of the partnership interest while the negative amount is present.

21. A limited partnership is one that has at least one limited partner and one general partner. As defined in most provincial legislation, a limited partner is one whose liability for the debts of the Partnership is limited to the amount of his contribution to the Partnership, and who is not permitted to participate in the management of the Partnership. A partner whose liability is limited under partnership law is considered a limited partner for income tax purposes.

22. Stated simply, the at-risk rules are designed to ensure that a limited partner does not receive tax deductions or tax credits that exceed the amount that he has “at risk”. In very simplified terms, the “at risk” amount is the amount of the partner’s actual investment, not including amounts owed to the limited partnership.

23. A Canadian partnership is defined in ITA 201 as follows:

    In this subdivision, "Canadian partnership" means a partnership all of the members of which were, at any time in respect of which the expression is relevant, resident in Canada.

    This is an important classification in that, in order to qualify for the various rollovers of partnership property, the partnership must meet this definition.

24. The incorporation of a partnership without incurring current taxation requires the use of two rollovers. The first (under ITA 85(2)), allows eligible partnership property to be transferred to a taxable Canadian corporation for either shares or a combination of shares and other consideration. The transfer takes place at elected values which can include the tax cost of the property, thereby avoiding current Taxable Income at the partnership level.

    At this point, the partnership is holding shares in the corporation and the partners are continuing to hold their partnership interests. The second rollover (under ITA 85(3)) then provides for a transfer at tax values of the partnership’s holding of the corporation's shares to the partners in return for their partnership interests.

TIF Solution Eighteen - 2

New For 2016/2017

1. False. While partnerships are not taxable entities for income tax purposes, they are taxable entities for GST/HST purposes.

2. False. Participants in joint ventures may have a significantly different Tax Payable than would be the case if they were considered to be partners.

3. True.

4. True.

5. False. Interest on capital contributions cannot be deducted.

6. True.

7. False. While only one-half of allocated capital gains will be included in a partner's Net Income For Tax Purposes, 100 percent of such gains will be added to the partner's adjusted cost base.

8. True.

9. True.

10. False. A rollover treatment is available where all of the property of a Canadian partnership that has ceased to exist is transferred to a new Canadian partnership. A further condition is that all of the members of the new partnership must have been members of the old partnership.

Retained From Previous Editions

11. True.

12. True.

13. False. Salaries paid to partners are never deductible.

14. True.

15. False. Charitable donations are allocated to the partners on the basis of the partnership agreement.

TIF Solution Eighteen - 3

New For 2016/2017

1. B. Limited partners cannot participate in the management of the company.

2. D. While partners share the profit of the partnership, joint venturers share the gross revenues of the joint venture.

3. B. $228,000.

4. D. Her share of the dividend gross up on dividends received by the partnership during the year.

5. C. $60,000 [$200,000 + (50%)($40,000) - ($200,000 - $50,000)]

6. B. A decrease of $15,000 ($155,000 - $140,000).

Retained From Previous Editions

7. A. One of the partners must be an individual.

8. B. Partners are jointly and severally liable for partnership debt and wrongful acts of other partners.

9. B. General partners are a separate legal entity from the business.

10 A. Partners may be able to reduce their personal income taxes if the business has losses in the start-up years.

11. C. 3 and 4.

12. A. When profits or losses are accounted for individually.

13. D. Co-venturers do not have the power to bind other co-venturers contractually.

14. D. A syndicate.

15. A. Martin will be allocated charitable donations of $1,800 [(30%)($6,000)]. He will include on his tax return:

• taxable capital gains of [(30%)(1/2)($42,000)]	$6,300
• a federal dividend tax credit of [(30%)(21/29)(17%)($15,000)]	$554
• a charitable donations tax credit of [(15%)($200) + (29%)($1,800 - $200)]	$494

16. C. $229,720 {[50%][$490,000 + (17%)($32,000) - (1/2)($96,000) + $12,000]}.

17. C. $59,000 [(50%)($130,000) – (50%)($5,000) - $3,500)]

18. B. $222,000 + $120,000 - $1,500 - $100,000 = $240,500

19. C. Business losses of a partnership cannot be allocated to the partners for them to deduct against other sources of income.

20. A. The ACB of Joe's partnership interest is $23,000, calculated as follows:

Opening ACB	$59,000
Drawings	(10,000)
Share Of Net Business Loss	(25,000)
Share Of Charitable Donations	(1,000)
ACB	$23,000

21. D. The ACB of Sarah's partnership interest is $60,000, calculated as follows:

Opening ACB	$40,000
Drawings	(15,000)
Share Of Business Income - No CCA Adjustment [(50%)($50,000)]	25,000
Share Of Capital Gains [(50%)(2)($10,000)]	10,000
ACB	$60,000

22. A. Each sister will have a taxable capital gain of $2,500. [1/2][$15,000 – (20%)($50,000)]

23. C. $34,000. [($215,000 - $5,000)(40%) - $50,000]
Net business income of the partnership for tax purposes is $215,000 {[$200,000 + (1/2)($20,000) + $5,000]}. Jabari's 40 percent share of the income is reduced by his share of the charitable donation and 100 percent of his withdrawals.

24. C. The adjusted cost base is nil. Kasinda will report partnership business income of $100,000. [$100,000 = (25%)($400,000)]

25. A. If Blue Grass pays $20,000 directly to each of the original partners, the adjusted cost base of the partnership interest of both Red Bush and Green Tree would decrease by $20,000 each. Each partner is selling one third of their $60,000 interest. This will reduce their adjusted cost base by $20,000 [(1/3)($60,000)].

26. B. Blue Grass pays $30,000 directly to both of the original partners. This will result in a $10,000 capital gain ($30,000 - $20,000).

27. C. [(1/2)($65,000 + $8,000 (add negative) - $2,000)] = $35,500

28. C. Interest on funds borrowed by a partner to make a capital contribution.

29. A. Mayumi, a partner in an engineering firm, entitled to 50% of the profits and responsible for 50% of losses. This is the only choice where the partner does not have some type of special guarantee from the partnership that limits their financial liability.

30. B. The objective of the rules is to prevent taxpayers from receiving tax deductions or tax credits in excess of the amount that they are in a position to lose on their investment.

31. C. To ensure that the tax deductions available to limited partners do not exceed the amount they have at-risk.

32. B. It has an indefinite carry forward period, cannot be carried back, and can only be used against limited partnership income from the same limited partnership.

33. C. His limited partnership loss can be carried forward indefinitely and carried back 3 years. There is no carry back.

34. C. Aba will have disposed of the truck for $35,000 resulting in recapture. The adjusted cost base of her partnership interest will be $30,000. The partnership will have acquired the truck for $35,000.

35. B. Aissa will have disposed of the land for $95,000 resulting in a taxable capital gain of $25,000. The ACB of her partnership interest will be $95,000. The partnership will have acquired the land for $95,000.

36. B. A decrease of $78,900. [(35%)($88,000-$62,000)-$88,000]

37. C. Inventory of real property.

TIF Solution Eighteen - 4

Exam Exercise Solution Eighteen - 1 (Partnership Income - Accrual Basis)

The following amounts would be added to Ms. Winter's Net Income For Tax Purposes:

Business Income [(40%)($80,000)]	$32,000
Taxable Capital Gains [(40%)(1/2)($23,000)]	4,600
Eligible Dividends [(40%)($8,500)]	3,400
Gross Up [(38%)($3,400)]	1,292
Total	$41,292

In addition Ms. Winters would be eligible for a federal dividend tax credit of $705 [(6/11)($1,292)]. The fact that she withdrew $25,000 during the year has no immediate tax consequences.

Exam Exercise Solution Eighteen - 2 (Partnership Income - Accrual Basis)

The following amounts would be added to Mr. Bonner's Net Income For Tax Purposes:

Business Income [(25%)($140,000)]	$35,000
Taxable Capital Gains [(25%)(1/2)($18,000)]	2,250
Eligible Dividends [(25%)($41,000)]	10,250
Gross Up [(38%)($10,250)]	3,895
Total	$51,395

In addition Mr. Bonner would be eligible for a federal dividend tax credit of $2,125 [(6/11)($3,895)]. The fact that he withdrew $15,000 during the year has no immediate tax consequences.

Exam Exercise Solution Eighteen - 3 (Partnership Net Business Income)

The ID Partnership's Net Business Income would be calculated as follows:

Accounting Net Income		$312,000
Add:		
Salary To I	$42,000	
Interest To D	17,000	
Amortization Expense	41,000	
Donations	4,200	104,200
		$416,200
Deduct:		
Maximum CCA	($63,000)	
Accounting Gain On Sale Of Land	(31,000)	(94,000)
Net Business Income		$322,200

The allocation of this Net Business Income to the two partners would be as follows:

	Partner I	Partner D
Priority Allocation For Salary	$ 42,000	N/A
Priority Allocation For Interest	N/A	$ 17,000
Allocation Of Residual		
[(55%)($322,200 - $42,000 - $17,000)]	144,760	
[(45%)($322,200 - $42,000 - $17,000)]		118,440
Total Business Income Allocation	$186,760	$135,440

While not required, you might note that a taxable capital gain of $15,500 [(1/2)($31,000)], as well as the charitable donations of $4,200, would be allocated to the partners on a 55:45 basis.

Exam Exercise Solution Eighteen - 4 (Partnership Net Business Income)

The Keisha Partnership's Net Business Income would be calculated as follows:

Accounting Net Income		$625,000
Additions		
Non-Deductible Meals And Entertainment [(50%)($32,000)]	$16,000	
Loss On Sale Of Investments	48,000	
Golf Club Dues	25,000	
Amortization Expense	62,000	151,000
Deductions		
CCA	($47,000)	
Terminal Loss	(31,000)	(78,000)
Net Business Income		$698,000

Each partner would be allocated $349,000 [(50%)($698,000)].

While not required, you might note that the capital loss will be allocated to the partners on a 50:50 basis. However, they can deduct it only to the extent that they have offsetting capital gains.

Exam Exercise Solution Eighteen - 5 (Partnership Income Allocations)

The MP Partnership's Net Business Income would be calculated as follows:

Accounting Net Income	$78,000
Amortization Expense = CCA	Nil
Eligible Dividends	(6,500)
Accounting Gain On Sale Of Land	(16,000)
Net Business Income	$55,500

The addition to Net Income For Tax Purposes for each of the two partners would be calculated as follows:

	Partner M	Partner P
Net Business Income [(50%)($55,500)]	$27,750	$27,750
Eligible Dividends [(50%)($6,500)]	3,250	3,250
Gross Up [(38%)($3,250)]	1,235	1,235
Taxable Capital Gain [(50%)(1/2)($16,000)]	4,000	4,000
Net Income For Tax Purposes Addition	$36,235	$36,235

While not required, you might note that each partner would be eligible for a federal dividend tax credit of $674 [(6/11)($1,235)].

Exam Exercise Solution Eighteen - 6 (Partnership Income Allocations)

The Barton Partnership's Net Business Income would be calculated as follows:

Accounting Net Income	$242,000
Eligible Dividends	(14,000)
Accounting Gain On Sale Of Land	(52,000)
Net Business Income	$176,000

The addition to Net Income For Tax Purposes for each of the two partners would be calculated as follows:

	Sam (40%)	Sherri (60%)
Net Business Income = $176,000	$70,400	$105,600
Eligible Dividends = $14,000	5,600	8,400
Gross Up		
[(38%)($5,600)]	2,128	
[(38%)($8,400)]		3,192
Taxable Capital Gain = $26,000		
[(1/2)($52,000)]	10,400	15,600
Net Income For Tax Purposes Addition	$88,528	$132,792

While this is not required, you might note that each partner would be eligible for a federal dividend tax credit equal to 6/11 of their respective gross ups.

Exam Exercise Solution Eighteen - 7 (Allocations To Partners - Related Tax Credits)

The allocation of the amounts would be as follows:

	Partner P (40%)	Partner U (60%)
Charitable Donations = $4,200	$1,680	$2,520
Political Contributions = $900	360	540
Dividends = $2,700	1,080	1,620

Using these allocations, the tax credits for the two partners would be calculated as follows:

Partner P	
Charitable Donations	
[(15%)($200) + (29%)($1,680 - $200)]	$459
Political Contributions [(3/4)($360)]	270
Dividends [(6/11)(38%)($1,080)]	224
John's Credits	$953

Partner U	
Charitable Donations	
[(15%)($200) + (29%)($2,520 - $200)]	$ 703
Political Contributions [(3/4)($400) + (1/2)($140)]	370
Dividends [(6/11)(38%)($1,620)]	336
Partner U's Credits	$1,409

These amounts would serve to reduce the Tax Payable of each of the two partners for the year ending December 31, 2016.

Exam Exercise Solution Eighteen - 8
(Allocations To Partners - Related Tax Credits)

The allocation of the amount would be as follows:

	John (60%)	Jill (40%)
Charitable Donations = $4,500	$2,700	$1,800
Political Contributions = $600	360	240
Dividends = $14,000	8,400	5,600

Using these allocations, the tax credits for the two partners would be calculated as follows:

John	
Charitable Donations	
[(15%)($200) + (29%)($2,700 - $200)]	$ 755
Political Contributions [(3/4)($360)]	270
Dividends [(6/11)(38%)($8,400)]	1,741
John's Credits	$2,766

Jill	
Charitable Donations	
[(15%)($200) + (29%)($1,800 - $200)]	$ 494
Political Contributions [(3/4)($240)]	180
Dividends [(6/11)(38%)($5,600)]	1,161
Jill's Credits	$1,835

These amounts would serve to reduce the Tax Payable of each of the two partners for the year ending December 31, 2016.

Exam Exercise Solution Eighteen - 9 (Admission Of A Partner)

Natasha and Felicia will each have a disposition of one-third of their partnership interests for $124,000. As the adjusted cost base of the interest sold is $49,600 [(1/3)($148,800)], Natasha and Felicia will each have a $37,200 [(1/2)($124,000 - $49,600)] taxable capital gain.

The capital account balances and the ACBs after Kyra's admission will be:

	Natasha	Felicia	Kyra
Opening Capital Accounts	$148,800	$148,800	Nil
Adjustment For Kyra's Admission	(49,600)	(49,600)	$ 99,200
Ending Capital Accounts (Accounting Values)	$ 99,200	$ 99,200	$ 99,200
ACB Of Partnership Interest	$ 99,200	$ 99,200	$248,000

Exam Exercise Solution Eighteen - 10 (Admission Of A Partner)

Jerry and Joan will each have a disposition of one-third of their partnership interests for $130,000. As the adjusted cost base of the interest sold is $70,000 [(1/3)($210,000)], they will each have a taxable capital gain of $30,000 [(1/2)($130,000 - $70,000)].

The capital account balances and the ACBs after John's admission would be calculated as follows:

	Jerry	Joan	John
Opening Capital Accounts	$210,000	$210,000	Nil
Adjustment For John's Admission	(70,000)	(70,000)	$140,000
Ending Capital Accounts (Accounting Values)	$140,000	$140,000	$140,000
ACB Of Partnership Interest	$140,000	$140,000	$260,000

Exam Exercise Solution Eighteen - 11 (Adjusted Cost Base Of Partnership Interest)

The ACB of Roberta's partnership interest on December 31, 2016 and January 1, 2017 would be determined as follows:

Original Capital Contribution	$ 52,500
Additional Contribution [ITA 53(1)(e)]	30,240
Drawing	(16,800)
ACB - December 31, 2016	$ 65,940
Adjustment For 2016 Income [(40%)($48,720 + $13,020 + $196,140)]	103,152
ACB - January 1, 2017	$169,092

Roberta's inclusion in Net Income For Tax Purposes would be as follows:

Taxable Capital Gain [(1/2)($48,720)]	$ 24,360
Dividends Received	13,020
Gross Up On Eligible Dividends [(38%)($13,020)]	4,948
Net Business Income	196,140
Subtotal	$238,468
Roberta's Share Of Profits	40%
Inclusion In 2016 Net Income For Tax Purposes	$ 95,387

Note that this is not the same $103,152 that was added to the ACB of Roberta's partnership interest to reflect her share of 2016 partnership income.

Exam Exercise Solution Eighteen - 12
(Adjusted Cost Base Of Partnership Interest)

The adjusted cost base of Xena's partnership interest on December 31, 2016 and January 1, 2017 would be determined as follows:

Original Capital Contribution	$125,000
Additional Contribution	75,000
Drawing	(40,000)
ACB - December 31, 2016	$160,000
Adjustment For 2016 Income	
[(60%)($435,000 + $26,000 + $31,000)]	295,200
ACB - January 1, 2017	$455,200

Xena's inclusion in Net Income For Tax Purposes would be as follows:

Net Business Income	$435,000
Taxable Capital Gain [(1/2)($31,000)]	15,500
Dividends Received	26,000
Gross Up On Eligible Dividends [(38%)($26,000)]	9,880
Subtotal	$486,380
Xena's Share Of Profits	60%
Inclusion In 2016 Net Income For Tax Purposes	$291,828

Note that this is not the same $295,200 that was added to the adjusted cost base of Xena's partnership interest to reflect her share of 2016 partnership income.

Exam Exercise Solution Eighteen - 13 (Limited Partnership Losses)

The required calculations are as follows:

ACB Of Partnership Interest		$235,000
Share Of Partnership Income For 2016		Nil
Subtotal		$235,000
Amounts Owed To The Partnership	($173,000)	
Other Amounts Intended To Reduce Investment Risk (General Partner Guarantee)	(62,000)	(235,000)
At-Risk Amount - December 31, 2016		Nil

As the at-risk amount is nil, none of the loss can be deducted in 2016. The limited partnership loss at the end of 2016 is 100 percent of the $81,400 loss allocation.

Exam Exercise Solution Eighteen - 14 (Limited Partnership Losses)

The required calculations are as follows:

ACB Of Partnership Interest		$450,000
Share Of Partnership Income For 2016		Nil
Subtotal		$450,000
Amounts Owed To The Partnership	($200,000)	
Other Amounts Intended To Reduce Investment Risk (General Partner Guarantee)	(100,000)	(300,000)
At-Risk Amount - December 31, 2016		$150,000

As the at-risk amount is $150,000, all of the $132,000 loss can be deducted in 2016. The limited partnership loss at the end of 2016 is nil ($132,000 - $132,000).

Exam Exercise Solution Eighteen - 15 (Transfers From Partner To Partnership - No Rollover)

Part A Martha is considered to have disposed of the land for $180,000, resulting in a $60,300 [(1/2)($180,000 - $59,400)] taxable capital gain. She is also considered to have made a capital contribution of $180,000 that will be added to the ACB of her partnership interest. HP will be considered to have acquired the land for $180,000.

Part B Martha will have the same $60,300 taxable capital gain as in Part A and HP will be considered to have acquired the land for $180,000. The capital contribution and the addition to the ACB of the partnership interest is $135,000. This is the difference between the fair market value of the land transferred to HP of $180,000 and the $45,000 in other consideration received by Martha on the property transfer.

Part C Martha will have the same $60,300 taxable capital gain as in Part A and HP will be considered to have acquired the land for $180,000. No capital contribution is made. As Martha withdrew $21,600 ($201,600 - $180,000) more from HP than she transferred in, Martha will be considered to have made a net withdrawal. The ACB of her partnership interest will be reduced by $21,600.

Exam Exercise Solution Eighteen - 16 (Transfers From Partner To Partnership - No Rollover)

Part A Ethan is considered to have disposed of the land for its fair market value of $220,000, resulting in a taxable capital gain of $60,000 [(1/2)($220,000 - $100,000). This capital contribution will increase the adjusted cost base of her partnership interest by $220,000. The adjusted cost base of the land to CP will be $220,000.

Part B Ethan is considered to have disposed of the land for its fair market value of $220,000, resulting in a taxable capital gain of $60,000 [(1/2)($220,000 - $100,000)]. However, as he has received $60,000 in cash, the adjusted cost base of his partnership interest will only be increased by $160,000 ($220,000 - $60,000). The adjusted cost base of the land to CP will be $220,000.

Part C Once again, Ethan will have a taxable capital gain of $60,000 and CP will have acquired the land for $220,000. However, as Ethan has received an amount in excess of the fair market value of the land, there will be no increase in the adjusted cost base of his partnership interest. Rather, this value will be reduced by the $30,000 ($250,000 - $220,000) excess of the cash payment over the fair market value of the land. In effect, this $30,000 will be treated as a drawing.

Exam Exercise Solution Eighteen - 17 (Transfers From Partnership To Partners)

ITA 98(2) deems Trident to have disposed of the debenture bonds for their fair market value of $611,750, resulting in a $44,000 ($611,750 - $567,750) capital gain. One-tenth of the capital gain, or $4,400, will be allocated to Lamar. One-half of this amount, or $2,200, will be a taxable capital gain that he will include in his income for 2016. Lamar will also be considered to have acquired his share of the debenture bonds for $61,175.

The adjusted cost base of his partnership interest on December 31, 2016 and on January 1, 2017 is calculated as follows:

Partnership Adjusted Cost Base Prior To The Distribution	$75,800
Drawings [(10%)($611,750)]	(61,175)
Adjusted Cost Base - December 31, 2016	$14,625
Allocated Capital Gain [(10%)(($611,750 - $567,750)]	4,400
Adjusted Cost Base - January 1, 2017	$19,025

Exam Exercise Solution Eighteen - 18 (Transfers From Partnership To Partners)

The distribution will be treated as a disposition of the securities at their fair market value of $475,000. This means that the Partnership will have a capital gain of $225,000 ($475,000 - $250,000). Of this amount, $56,250 [(25%)($225,000)] will be allocated to Patricia. She will have a taxable capital gain of $28,125 [(1/2)($56,250)] which will be included in her 2016 Net Income For Tax Purposes. The adjusted cost base of the securities received will be $118,750 [(25%)($475,000)].

The adjusted cost base of her partnership interest on December 31, 2016 and on January 1, 2017 is calculated as follows:

Partnership Adjusted Cost Base Prior To The Distribution	$180,000
Drawings [(25%)($475,000)]	(118,750)
Adjusted Cost Base - December 31, 2016	$ 61,250
Allocated Capital Gain [(25%)(($475,000 - $250,000)]	56,250
Adjusted Cost Base - January 1, 2017	$117,500

Exam Exercise Solution Eighteen - 19
(Transfers From Partner To Partnership - Rollover)

Using the ITA 85(1) rollover provision, the property would be transferred at the $146,000 ACB of the land. Given this, the transfer would not result in any current income for Sol. The cost of the land to the partnership would be the $146,000 elected value for the transfer. This same amount would be added to the adjusted cost base of Sol's partnership interest.

Exam Exercise Solution Eighteen - 20
(Transfers From Partner To Partnership - Rollover)

Using the ITA 85(1) rollover provision, the property would be transferred at the $250,000 adjusted cost base of the land. Given this, the transfer would not result in any current income for Sarah. The cost of the land to the partnership would be the $250,000 elected value for the transfer. This same amount would be added to the adjusted cost base of Sarah's partnership interest.

TIF Solution Eighteen - 5A

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

A. 7

B. 9

C. 4

D. 8

E. 10

F. 3

G. 6

H. 1

The two unused definitions are as follows:

Joint Venture = 5

Limited Partner = 2

TIF Solution Eighteen - 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. 10 (not12)

B. 13 (not 2)

C. 5

D. 11

E. 14

F. 4 (not 8)

G. 7

H. 1

The three unused definitions are as follows:

Joint Venture = 6

Limited Partner = 3

Partnership = 9

TIF Solution Eighteen - 6

Basis For Conclusion

The following three partnership elements must be met for a partnership to exist:

1. Is there a business?
2. Is the business carried on for profit?
3. Is the business carried on in common by two or more persons?

In both Cases, a business definitely exists. The partnership concept of a business is much broader than that of the ITA. Any commercial undertaking will generally qualify. The repair business qualifies as a business under partnership law.

Case A

Although there is a business being carried on for profit, a partnership does not exist in Case A. There must be an intention to operate the business together. The existence of a partnership agreement, while helpful, is not determinative since actions often speak louder than words. However, only John has made real contributions to, and managed, the business. Furthermore, John does not hold himself out as a partner or the business a partnership, as the bank accounts and the business registration is in his name only.

Case B

It appears that Janet's involvement in the repair business is significant enough that the "in common" element is satisfied in Case B. Although the business is not yet profitable, there is a potential for profit. In the initial or start-up years many businesses experience losses, yet profit expectations remain. As a result, a partnership exists in Case B.

TIF Solution Eighteen - 7

Part A - Income Inclusion

Net Business Income The calculation of the partnership's Net Business Income is as follows:

Net Income From Law Practice		$230,000
Additions:		
Previous Year End Work-In-Process	$163,000	
Amortization	41,000	
Charitable Donations	26,000	
Drawings By Partners ($212,000 + $241,000)	453,000	683,000
		$913,000
Deductions:		
Current Year End Work-In-Process	($314,000)	
Maximum CCA	(54,000)	(368,000)
Net Business Income		$545,000

Other Sources Additional inclusions related to partnership activities would be as follows:

Eligible Dividends Received	$46,000
Gross Up [(38%)($46,000)]	17,480
Taxable Capital Gains [(1/2)($68,000)]	34,000
Total Other Sources	$97,480

The partnership income components would be allocated as follows:

	Sara	Ann
Business Income [(50%)($545,000)]	$272,500	$272,500
Other Sources [(50%)($97,480)]	48,740	48,740
Total Allocation	$321,240	$321,240

Part B - Tax Credits

Charitable Donations Each of the sisters would be allocated $13,000 [(50%)($26,000)] of the charitable donations. This would provide a federal tax credit of $3,742 [(15%)($200) + (29%)($13,000 - $200)] assuming this is their only charitable donation.

Dividends Each of the sisters would be eligible for a federal dividend tax credit of $4,767 [(50%)(6/11)($17,480)].

TIF Solution Eighteen - 8

Part A - Income Inclusion

The calculation of the partnership's Net Business Income is as follows:

Net Business Income (From Statement)		$380,000
Additions:		
Previous Year End Work-In-Process	Nil	
Amortization	32,000	
Business Meals And Entertainment [(1/2)($14,000)]	7,000	
Charitable Donations	13,000	
Salaries To Partners [(2)($150,000)]	300,000	352,000
		$732,000
Deductions:		
Current Year End Work-In-Process	($56,000)	
Maximum CCA	(41,000)	(97,000)
Net Business Income		$635,000

Additional inclusions related to partnership activities would be as follows:

Taxable Capital Gains [(1/2)($8,000)]	$ 4,000
Eligible Dividends Received	16,000
Gross Up [(38%)($16,000)]	6,080
Total Other Sources Of Income	$26,080

The total inclusion in each brother's Net Income For Tax Purposes would be calculated as follows:

	Sam	Allen
Net Business Income [(50%)($635,000)]	$317,500	$317,500
Other Sources Of Income		
Sam [(20%)($26,080)]	5,216	
Allen [(80%)($26,080)]		20,864
Inclusion In Net Income For Tax Purposes	$322,716	$338,364

Part B - Tax Credits

Charitable Donations
Each of the brothers would be allocated $6,500 [(50%)($13,000)] of the charitable donations. This would provide a federal tax credit of $1,857 [(15%)($200) + (29%)($6,500 - $200)] assuming this is their only charitable donation.

Dividends
As Sam was allocated only 20 percent of the dividends, his federal dividend tax credit will be $663 [(20%)(6/11)($6,080)].

Allen's credit will be $2,653 [(80%)(6/11)($6,080)].

TIF Solution Eighteen - 9

Part A - Income From The Partnership

Income from the partnership is as follows:

Accounting Income For The Period		$ 40,000
Additions:		
Partners' Salaries	$130,000	
50 Percent Of Meals And Entertainment	3,000	133,000
		$173,000
Deductions:		
Work In Progress (Note)	($ 25,000)	
CCA:		
Class 50 [(1/2)(55%)($10,000)]	(2,750)	
Class 12 [($8,000)(100%)(1/2)]	(4,000)	(31,750)
Net Business Income		$141,250

Note Provided the partners elect under ITA 34, work in progress can be excluded from their Net Income For Tax Purposes.

Based on the preceding calculation, each partner must include $70,625 [(50%)($141,250)] of business income from the partnership in their 2016 tax return.

Part B - Deductible Expenses Incurred Personally

The partners may also be able to deduct the following expenses, if they have incurred them personally:

- Any interest expense related to financing their capital contribution of $10,000.
- The business portion of any car expenses.
- Any promotion expenses, subject to the 50 percent limitation on meals and entertainment.
- Expenses for an office in the home (to a maximum of business income before the deduction), if the work space is used exclusively for business purposes and it is used on a regular and continuous basis for meeting clients.

Part C - ACB Of Partnership Interest

The ACB of each partnership interest is as follows:

Capital Contribution	$10,000
Salary (Drawings) [(50%)($130,000)]	(65,000)
Negative ACB - December 31, 2016	($55,000)
Share Of Partnership Income For 2016	70,625
ACB - January 1, 2017	$15,625

TIF Solution Eighteen - 10

Part A - Adjusted Cost Base

The adjusted cost base of John Mathis' partnership interest would be calculated as follows:

Initial Capital Contribution	$200,000
Additional Capital Contribution	75,000
Total Capital Contribution	$275,000
Drawings	(55,000)
Net Business Income [(1/3)($233,460)]	77,820
Capital Gains To Monroe and Mathis [(50%)($18,464)]	9,232
Dividends To Darin	Nil
Charitable Donations [(1/3)($8,460)]	(2,820)
Adjusted Cost Base - January 1, 2017	$304,232

Note Only the taxable one-half of the capital gain is included in the partner's income on the flow through of capital gains realized by a partnership. However, the remaining one-half is included in the assets of the partnership and, in the absence of a special provision to deal with this situation, the realization of this amount would be added to any capital gain realized on the disposition of the partnership interest. Given this, the full amount of John's share of realized capital gains is added to the partnership adjusted cost base.

Part B - Taxable Capital Gain On Disposition

Given the preceding calculation, the gain on the disposition of the partnership interest can be calculated as follows:

Proceeds Of Disposition		$320,000
Adjusted Cost Base:		
From Preceding Calculation	($304,232)	
Legal And Accounting Fees	(1,800)	(306,032)
Capital Gain		$ 13,968
Inclusion Rate		1/2
Taxable Capital Gain		$ 6,984

This amount would be included in John Mathis's Net Income For Tax Purposes for 2017 as a taxable capital gain. He would not include any partnership income for January as he was not allocated any of this income.

Part C - Effect On Other Partners

The fact that each partner paid $160,000 to John in return for one-half of his interest means that both Bob Darin and Matt Monroe would have a $160,000 increase in the adjusted cost base of their partnership interest.

TIF Solution Eighteen - 11

Note We would remind you that in calculating the adjusted cost base of the partnership interest, a partner's share of either a loss or a gain is not added until the first day of the following taxation year.

At-Risk Amount On December 31, 2016

Adjusted Cost Base - December 31, 2016		$65,000
Add: Share Of Partnership Income (Not Losses) For 2016		
[(12%)($63,000 + $31,000 + $53,000)]		17,640
Subtotal		$82,640
Amounts Owed To The Partnership		
($65,000 - $5,000 - $10,000)	($50,000)	
Other Amounts That Reduce Risk	(5,000)	(55,000)
At-Risk Amount - December 31, 2016		$27,640

As the agreement effectively guarantees a value of no less than $5,000, even if the market value of the partnership interest is nil, this amount is not at risk and reduces the at-risk amount.

Limited Partnership Loss For The Year

Share Of 2016 Partnership Business Loss [(12%)($510,000)]	($61,200)
At-Risk Amount - December 31, 2016	27,640
Limited Partnership Loss For 2016	($33,560)

Deductible Loss For The Year

Share Of 2016 Partnership Business Loss [(12%)($510,000)]	($61,200)
Limited Partnership Loss For 2016	33,560
Deductible Loss For 2016	($27,640)

Limited Partnership Loss Carry Forward

There is a limited partnership loss carry forward of $33,560 at the end of 2016.

Adjusted Cost Base

The share of partnership income that is added to the at-risk amount is the amount that will be added to the ACB. It does not include the dividend gross up and it is not reduced by the non-taxable half of the capital gain.

Adjusted Cost Base - December 31, 2016	**$65,000**
Share Of Partnership Income For 2016	
[(12%)($63,000 + $31,000 + $53,000)]	17,640
Loss Deducted For 2016	(27,640)
Adjusted Cost Base - January 1, 2017	**$55,000**

At Risk Amount On January 1, 2017

As of January 1, 2017, the at-risk amount would be nil ($27,640 - $27,640).

TIF Solution Eighteen - 12

2016 Results

The required amounts would be calculated as follows:

ACB Of Partnership Interest - December 31, 2016	$150,000
Add: Share Of 2016 Partnership Income (Not Loss) [(30%)($50,000)]	15,000
Subtotal	$165,000
Amounts Owed To The Partnership	(100,000)
Other Amounts That Reduce Risk	(60,000)
At-Risk Amount - December 31, 2016	$ 5,000

Share Of 2016 Loss [(30%)($975,000)	($292,500)
At-Risk Amount - December 31, 2016	5,000
Limited Partnership Loss - December 31, 2016	($287,500)

Share Of 2016 Loss [(30%)($975,000)	($292,500)
Limited Partnership Loss - December 31, 2016	287,500
Deductible Loss For 2016	($ 5,000)

There is a limited partnership loss carry forward of $287,500 ($292,500 - $5,000).

2017 Results

ACB Of Partnership Interest - December 31, 2016	$150,000
2016 Capital Gain	15,000
Loss Deducted For 2016	(5,000)
ACB Of Partnership Interest - January 1, 2017	$160,000
Add: Share Of 2017 Partnership Income (Not Loss)	Nil
Subtotal	$160,000
Amounts Owed To The Partnership	Nil
Other Amounts That Reduce Risk	(60,000)
At-Risk Amount - December 31, 2017	$100,000

Share of 2017 Loss [(30%)($180,000)]	($ 54,000)
Limited Partnership Loss Carry Forward	(287,500)
At-Risk Amount - December 31, 2017	100,000
Limited Partnership Loss - December 31, 2017	($241,500)

Share of 2017 Loss [(30%)($180,000)]	($ 54,000)
Limited Partnership Loss Carry Forward	(287,500)
Limited Partnership Loss - December 31, 2017	241,500
Deductible Loss For 2017	($100,000)

This will leave a limited partnership loss carry forward of $241,500 ($287,500 + $54,000 - $100,000).

2018 Results

ACB Of Partnership Interest - December 31, 2017	$160,000
Loss Deducted For 2017	(100,000)
ACB Of Partnership Interest - January 1, 2018	$ 60,000
Add: Share Of 2018 Partnership Income	Nil
Subtotal	$ 60,000
Amounts Owed Partnership	Nil
Other Amounts That Reduce Risk	Nil
At Risk Amount - December 31, 2018	$ 60,000

Limited Partnership Loss Carry Forward	($241,500)
At-Risk Amount - December 31, 2018	60,000
Limited Partnership Loss - December 31, 2018	($181,500)

Limited Partnership Loss Carry Forward	($241,500)
Limited Partnership Loss - December 31, 2018	181,500
Deductible Loss For 2018	($ 60,000)

This will leave a limited partnership loss carry forward of $181,500 ($241,500 - $60,000).

Economic Analysis The following calculations will serve to explain the results that have been calculated in the preceding table:

2016 Loss [(30%)($975,000)]	$292,500
2017 Loss [(30%)($180,000)]	54,000
Total Loss For 2016 Through 2018	$346,500
2016 Investment	(50,000)
2016 Capital Gain [(30%)($50,000)]	(15,000)
2017 Investment	(100,000)
Undeducted Loss Carry Forward	$181,500

TIF Solution Eighteen - 13

Part A - Adjusted Cost Base Of Consideration

Cash The ACB of the cash would be its face value. These amounts would be $620,000 for Howard, $377,000 for Jones, and $203,000 for Delaney.

ACB Of Preferred Shares With respect to the preferred shares received, ITA 85(3)(e) indicates that their ACB will be the lesser of:

- Their fair market value, which would be $300,000 for each of the three partners.
- The ACB of their partnership interests, reduced by the amount of non-share consideration received.

This latter value would be calculated as follows for the three partners:

	Howard	Jones	Delaney
ACB	$1,173,000	$930,000	$756,000
Cash Received	(620,000)	(377,000)	(203,000)
Balance	$ 553,000	$553,000	$553,000

For all three partners, the lower figure is the fair market value of $300,000, therefore this would be the ACB of the preferred shares.

ACB Of Common Shares Under ITA 85(3)(f), the ACB of the common shares would be the ACB of the partnership interest, less the value of the non-share consideration received and the value assigned to the preferred shares. These amounts would be calculated as follows:

	Howard	Jones	Delaney
ACB - Partnership Interest	$1,173,000	$930,000	$756,000
Cash Received	(620,000)	(377,000)	(203,000)
ACB - Preferred Shares	(300,000)	(300,000)	(300,000)
ACB Of Common Shares	$ 253,000	$253,000	$253,000

Part B - Capital Gain Or Loss

As the non-share consideration had a value that was less than the value of the assets transferred, there will be no immediate gain or loss on this rollover. This can be demonstrated with the following calculation:

	Howard	Jones	Delaney
Proceeds Of Disposition:			
Cash	$ 620,000	$377,000	$203,000
Preferred Shares	300,000	300,000	300,000
Common Shares	253,000	253,000	253,000
Total Proceeds	$1,173,000	$930,000	$756,000
ACB	(1,173,000)	(930,000)	(756,000)
Capital Gain (Loss)	Nil	Nil	Nil

From an economic point of view the gain is still present. We have deferred recording it for tax purposes by placing a value on the common shares of $759,000 [(3)($253,000)]. This is $1,041,000 below their current fair market value of $1,800,000. Note that $1,041,000 is also the difference between the $3,900,000 fair market value of the total consideration given and the $2,859,000 value for the total ACB of the partnership interests.

TIF Solution Eighteen - 14

Shelly's Federal Tax Payable

The Net Business Income of the partnership would be calculated as follows:

Operating Income		$424,000
Additions:		
Amortization Expense	$ 9,000	
One-Half Meals And Entertainment	5,500	
Charitable Donations	23,000	37,500
Deductions:		
CCA	($14,000)	
Unbilled Work In Progress	(72,000)	(86,000)
Net Business Income		$375,500

Shelly's Taxable Income and share of charitable donations would be calculated as follows:

	Partnership	Share	Taxable Income
Partnership Business Income	$375,500	1/2	$187,750
Taxable Capital Gain [(1/2)($6,000)]	3,000	1/2	1,500
Partnership Dividends Received	13,000	1/2	6,500
17% Gross Up On Dividends Received	N/A		1,105
Taxable Income			$196,855
Charitable Donations	$23,000	1/2	$11,500

Based on the preceding calculation, Shelly's federal Tax Payable would be calculated as follows:

Tax On The First $140,388	$29,029
Tax On Additional	
$56,467 ($196,855 - $140,388) At 29 Percent	16,375
Tax Payable Before Credits	$45,404
Basic Personal Credit [(15%)($11,474)]	(1,721)
Dividend Tax Credit [(21/29)($1,105)]	(800)
Charitable Donations Credit (See Note)	(3,307)
Federal Tax Payable	$39,576

Note As none of Shelly's Taxable Income is in the 33 percent bracket, that rate is not relevant to the determination of the charitable donations tax credit. Given this the credit is $3,307 [(15%)($200) + (29%)($11,500 - $200)].

Taxable Capital Gain From Sale Of Partnership Interest

The adjusted cost base of Shelly's partnership interest on January 1,2017 would be calculated as follows:

	Partnership	Share	ACB
Capital Contribution	N/A		$235,000
2015 Partnership Business Income	$225,000	1/2	112,500
2015 Drawings	N/A		(72,000)
2016 Drawings	N/A		(187,000)
December 31, 2016			$ 88,500
2016 Partnership Business Income	$375,500	1/2	187,750
2016 Capital Gain	6,000	1/2	3,000
2016 Partnership Dividends Received	13,000	1/2	6,500
2016 Charitable Donations	(23,000)	1/2	(11,500)
January 1, 2017 Adjusted Cost Base			$274,250

Given this calculation, the taxable capital gain on Shelly's sale of the partnership interest would be calculated as follows:

Proceeds Of Disposition	$435,000
Adjusted Cost Base	(274,250)
Capital Gain	$160,750
Inclusion Rate	1/2
Taxable Capital Gain	$ 80,375

Chapter Nineteen Test Item File Solutions

TIF Solution Nineteen - 1

1. The roles of these persons can be described as follows:
   - The settlor is the person who contributes assets to the trust.
   - The trustee is the person who manages the trust. This would normally include the selection of investments as well as implementing other provisions of the trust agreement (e.g., distributions to beneficiaries).
   - A beneficiary is a person who will receive the capital or income benefits that are distributed by the trust.

2. This characteristic is of particular importance in the case of deceased individuals. Property distributions made in a deceased person's will can be challenged by a disgruntled beneficiary. A surviving spouse can re-direct assets after they have been bequeathed. The use of a trust makes challenges or variances for the deceased's wishes much more difficult.

3. From a general legal perspective, a trust is not a separate entity. However, for tax purposes, the *Income Tax Act* deems that a trust is deemed to be an individual. This means that a trust will have a Net Income For Tax Purposes, Taxable Income, and Tax Payable, all of which must be included in a separate tax return.

4. When an individual dies and bequeaths his property through a will, immediate distribution of all of his property may not be possible. During the period between an individual’s death and the time that all of his property is distributed to his beneficiaries, it is possible that some income will accrue on the estate property held by the executor. The deceased person’s income to the date of death will be included in his final tax return. However, the income earned by the estate during the period that it is administered by the executor cannot be allocated to either the deceased person or to his beneficiaries directly. To solve this problem, the *Act* requires that the income of the estate be included in a trust return (T3). As the rules for filing a return for this “estate” are the same as those applicable to a trust, the *Act* treats these two terms as synonyms.

5. As described in the CRA’s *Trust Guide*, the three characteristics that must be established with certainty are:
   1. the intent on the part of the settlor to create a trust;
   2. the identity of the property to be placed in the trust; and
   3. the identity of the beneficiary or beneficiaries of the trust.

6. While there are several other possibilities, the ones that are described in the Chapter are as follows:

   Administration Of Assets A trust can be used to provide for administration of assets by someone other than the beneficiary.

   Protection From Creditors A trust can be used to protect assets from the claims of creditors.

   Privacy Assets that are in a trust when an individual dies, or placed in a testamentary trust as the result of the individual’s death, are not subject to probate, a process where the results are available to the public.

   Avoiding Changes In Beneficiaries As trusts are difficult to change, placing assets in a trust ensures that they will ultimately be given to the intended beneficiaries.

7. As defined in the *Income Tax Act*, a personal trust is either a testamentary trust or, alternatively, an inter vivos trust in which no beneficial interest was acquired by paying consideration to either the trust or the settlor of the trust.

8. The basic model treats the various participants as follows:

   Settlor The transfer of property to the trust is, in general, considered to be a disposition. Possible tax consequences include capital gains, capital losses, recapture, and terminal losses. There are rollovers available for certain types of trusts such as alter ego trusts.

   Trust Income that is left in the trust is, in general, subject to tax at the maximum 33 percent federal tax rate that is applicable to individuals. The major exception to this general rules is a Graduated Rate Estate (GRE). GREs can use the same graduated rate schedule that is applicable to individuals. To the extent that this income is distributed to beneficiaries, it will be taxed in the hands of these individuals and deducted in determining the Taxable Income of the GRE.

   Beneficiaries The beneficiaries are, in general, taxed on income that distributed by the trust. Capital property, in general, is distributed by the trust to beneficiaries at the trust's tax cost.

9. The term testamentary trust refers to a trust that arises upon, and as a consequence of, the death of an individual. In contrast, an inter vivos trust refers to any personal trust other than a testamentary trust. Stated alternatively, an inter vivos (Latin for "among the living") trust is a trust created during the lifetime of the settlor.

   For inter vivos trusts and most testamentary trusts, the Tax Payable on all of the income that is left in the trust is calculated using the 33 percent maximum federal rate that is applicable to individuals. However, estate assets that have not been transferred to beneficiaries can be designated as a Graduated Rate Estate (GRE). Such GREs will calculate Tax Payable using the schedule of graduated rates used by individuals. A GRE may continue for up to 36 months after the individual whose estate assets are included has died.

10. For a trust to be classified as a qualifying spousal trust, the following conditions must be met:

    - The transferor's spouse is entitled to receive all of the income of the trust arising before the spouse or common-law partner's death.
    - No person other than the spouse may receive or benefit from any of the income or capital of the trust, prior to the death of the spouse or common-law partner.

    The major tax advantage of a spousal trust over other types of trusts is the fact that property can be transferred to this type of trust on a rollover basis. That is, the transfer will be recorded at tax values with no tax consequences accruing to the settlor.

    The two significant non-tax reasons for using a qualifying spousal trust are:

    - The trust can provide for the appropriate management of the transferred assets, particularly when these assets include an active business.
    - The trust can ensure that the assets are distributed in the manner desired by the settlor. While qualification requires that the transferred assets must "vest indefeasibly" with the spouse, the trust document can specify who the assets should be distributed to after the spouse or common-law partner dies. This could ensure, for example, that the assets are ultimately distributed only to the settlor's children if the spouse has remarried.

11. The following conditions must be met in order to establish an alter ego trust:
    - The settlor must be 65 years of age or over.
    - The settlor is entitled to receive all of the income of the trust that arises during the settlor's lifetime.
    - No person other than the settlor can receive or make use of the capital or income of the trust during the settlor's lifetime.

    The major tax advantage of these arrangements is that assets can be transferred into such trusts on a tax free basis. An additional tax feature is the possibility of establishing the trust in a low tax rate province, thereby minimizing the taxes that will arise at the time of death.

    With respect to the non-tax advantage of such arrangements, the basic feature is that the assets in the trust will not be part of the settlor's estate at the time of death. This means that these assets will not have to go through the probate process, a process that can be both costly and time consuming.

12. There are two major reasons why an individual might elect out of the rollover provision that is available on transfers to a joint spousal trust. The first is that he may have accumulated loss carry forwards or anticipates capital losses that could be used to eliminate the capital gains on the assets transferred. The second is that the transferred assets may include a property that qualifies for the lifetime capital gains deduction. If this is the case, that deduction could be used to eliminate all or part of the taxation that arises on the transfer.

13. In general, ITA 107(2) provides a tax free rollover of trust assets to a capital beneficiary. That is, the proceeds to the trust are deemed to be the trust's tax cost (i.e., adjusted cost base or UCC), with this amount also being recorded by the recipient beneficiary. The major exceptions to this rollover are as follows:
    - Transfers from a qualifying spousal or common-law partner trust to anyone other than a spouse or common-law partner.
    - Transfers from an alter ego trust to anyone other than the individual who settled the trust.
    - Transfers from a joint spousal or common-law partner trust to anyone other than the settlor or the spouse or common-law partner.

    In the case of these exceptions, the transfer will be recorded by the trust and the beneficiary at fair market value, usually resulting in a gain or loss in the trust.

14. This rule requires that there be a deemed disposition and reacquisition of trust capital property every 21 years. The disposition is deemed to be at fair market value, resulting in the recognition of any accrued gains on the assets. Like corporations, trusts have an unlimited life. In the absence of this rule, capital gains could accrue for an unlimited period of time inside the trust. This rule is designed to limit the accrual period.

15. The preferred beneficiary election is only available for individuals who qualify for the disability tax credit or for the infirm dependant over 17 years old tax credit. As such individuals usually have very little income, the objective of this provision is to allow the relevant amounts to be taxed at low rates, while not transferring the funds to an individual who might not be able to use them in an appropriate manner (e.g., a mentally infirm child).

16. The text describes two reasons for making such a designation:

    Instalment Avoidance While there is a legislative requirement that inter vivos trusts and testamentary trusts, other than those designated graduated rate estates, pay instalments, it appears that the CRA will waive these requirements on an administrative basis.

    Use Of Trust Losses A trust cannot allocate losses to beneficiaries. This means that the only way that an unused current year trust loss can be used is through a carry over to another year. With many trusts, this cannot happen under normal circumstances because they are required to distribute all of their income to beneficiaries, resulting in a nil Net Income For Tax Purposes. A solution to this problem is to designate sufficient income as having not been paid to absorb the loss carry forward. This can satisfy the legal requirement to distribute the income, while simultaneously creating sufficient Net Income For Tax Purposes to utilize the loss carry forward to save the beneficiaries taxes.

    Prior to 2016, this provision could be used to lower tax rates. This would be the case when the tax rate applicable to the trust income was lower than the rate applicable to the relevant beneficiary. However, as of 2016, this provision can only be used to eliminate trust losses. It cannot be used to create positive amounts of Taxable Income in the trust.

17. A discretionary trust is one in which the trustees are given the power to decide the amounts that will be allocated to each of the beneficiaries, usually on an annual basis. In contrast, a non-discretionary trust is one in which the amounts and timing of allocations to income and capital beneficiaries are specified in the trust agreement.

18. If the trust distributes all of the capital gain to a beneficiary, there will be no tax consequences for the trust. The beneficiary will be taxed on one-half of the capital gain.

    If the trust does not distribute the gain, one-half will be subject to tax within the trust, with the remaining one-half becoming part of the trust's capital balance. As part of the capital balance, this one-half of the gain can be distributed on a tax free basis to beneficiaries.

19. The income paid to the widow and son will be taxed in their hands in the year paid and will be deductible to the trust.

    For the first 36 months after the decedent's death, the earnings that are accumulating in the GRE will be taxed in the trust using the same schedule of progressive rates that is applicable to individuals. After that period, any income that remains in the trust will be taxed at the maximum federal rate of 33 percent that is applicable to individuals.

    There is no income attribution to deceased individuals.

20. If a trust is considered to be reversionary, any income generated by property that the settlor has transferred to the trust will be attributed to him, rather than to the intended beneficiaries. This would include capital gains resulting from a disposition of trust property.

21. While the term is not defined in the *Income Tax Act*, the term is usually applied to a personal trust that has been established with members of the settlor's family as beneficiaries. The usual objective of such trusts is income splitting.

22. The required three can be selected from the following that were described in the text:

    Intent Of The Testator The foremost goal of estate planning is to ensure that the wishes of the testator (a person who has died and left a will) are carried out. This will involve ensuring that the assets left by the testator are distributed at the appropriate times and to the specified beneficiaries.

    Preparation Of A Final Will The major document in the estate planning process is the final will. It should be carefully prepared to provide detailed instructions for the disposition of assets, investment decisions to be made, and the extent to which trusts will be used.

    Preparation Of A Living Will Equally important to the preparation of a final will, a living will provides detailed instructions regarding investments and other personal decisions in the event of physical or mental incapacity at any point in a person's lifetime.

    Ensuring Liquidity A plan should be established to provide for liquidity at the time of death.

    Simplicity While the disposition of a large estate will rarely be simple, effective estate planning should ensure that the plan can be understood by the testator and all beneficiaries of legal age.

    Avoidance Of Family Disputes If equitable treatment of beneficiaries is a goal of the testator, efforts should be made to ensure that all beneficiaries believe that they have been treated in an equitable manner.

    Expediting The Transition The procedures required in the settlement of an estate should be designed to expedite the process.

22. The two major disadvantages are as follows:

    - If the current market value of the property exceeds its tax value, a gift will be treated as a disposition, resulting in the creation of Taxable Income at the time of the gift.
    - If the property is an ongoing business, the individual making the gift will lose control of the property.

TIF Solution Nineteen - 2

New For 2016/2017

1. False. The trustee(s) hold the formal legal title to the trust property.

2. True.

3. False. While it is generally advisable to have a trust agreement in writing, oral agreements can be used to establish a trust.

4. True.

5. True.

6. False. Only individuals who are 65 or older can establish an Alter Ego trust.

7. False. There are several rollovers that can be used to transfer assets at tax value (e.g., transfers to a spousal trust).

8. True. Such transfers are usually made at the trust's tax cost. An exception would be a transfer of assets out of an Alter Ego trust to someone other than the settlor.

9. False. All of the income of an inter vivos trust is taxed at the maximum federal rate of 33 percent.

10. True.

Retained From Previous Editions

11. False. While the identity of the beneficiaries is an essential characteristic, their respective income allocations are not.

12. True.

13. False. They are taxed at a flat rate of 33 percent at the federal level.

14. False. Both income and capital gains will be attributed back to the spouse who is the settlor.

TIF Solution Nineteen - 3

New For 2016/2017

1. D. Amounts earned in these trusts are not subject to the income attribution rules.

2. A. 1, 2 and 4

3. C. Martin will report a taxable capital gain of $65,000 [(1/2)($300,000 - $170,000)]. The trust will have no income. Shorty will report dividends received of $21,000 which must be grossed up and will claim the dividend tax credit.

4. E. Items B and C.

5. A. $69,000 [(138%)($50,000)]

6. D. Charitable donation tax credit = [(15%)($200) + (33%)($14,800)] = $4,914
Trust TP = [(33%)($150,000 - $105,000) - $4,914 = $9,936

7. C. Any capital gains that are retained in the trust will not be attributed back to Mr. Holt.

8. D. Tim has acquired a capital interest in the trust with an adjusted cost base of $1,050,000. Jerry will report a taxable capital gain of $337,500 {[1/2][$1,050,000 - (50%)($750,000)]}.

9. B. $9,821 [(33%)($45,000) – (15%)($45,000 - $11,474)]

10. B. The use of Section 85 to implement the estate freeze can avoid immediate tax consequences.

Retained From Previous Editions

11. B. The individual beneficiaries must be named. Naming individual beneficiaries is not necessary as long as the beneficiaries are members of an identifiable group (e.g., the settlor’s children).

12. B. The trustee will hold formal legal title to the trust property.

13. B. The trust return is due 90 days after the trust's year end.

14. C. A trust can be used to avoid the income attribution rules applicable to a spouse. In general, it is not possible to avoid the income attribution rules by transferring assets to a trust in favour of a spouse.

15. B. A spousal trust created to benefit a spouse.

16. D. An alter ego trust.

17. B. The settlor must be 65 years of age or older. There is no age requirement for the settlor.

18. D. When assets are transferred out of an alter ego trust to anyone other than the settlor, the proceeds of disposition to the trust will be the fair market value of the assets transferred.

19. B. Anika should transfer the property to a common-law partner trust.

20. A. In 2015, a rollover would allow Diego to transfer his property to the trust tax free. In 2016, when the trust transfers the property to his son, the trust will include a taxable capital gain of $200,000 [(1/2)($800,000 - $400,000)] in income as it is an alter ego trust.

21. B. In 2015, there will be no rollover available, and Emilio will include a taxable capital gain of $175,000 [(1/2)($750,000 - $400,000)] in income. In 2016, when the trust transfers the property to his daughter, there will be a rollover available, and the trust will not report any income.

22. C. The difference between the fair market value and the cost of assets transferred to a capital beneficiary. While there are some exceptions to this, such transfers are recorded at tax values and do not generate any income for the trust.

23. C. $15,800. This would be calculated as follows:

Dividends Received	$20,000
Gross-Up On Dividends [($20,000)(38%)]	7,600
Interest Income ($10,000 - $5,000)	5,000
Interest Expense	(1,000)
Taxable Income - Trust	$31,600
Mrs. Allen's Percentage	50%
Taxable Income - Mrs. Allen	$15,800

24. B. $13,000. [$8,000 + $5,000]

25. C. A trust can deduct amounts allocated to, but not distributed to, a preferred beneficiary.

26. A. $249,000. This would be calculated as follows:

Non-eligible dividends received	$200,000
Gross-Up on Non-eligible Dividends [($200,000)(17%)]	34,000
Taxable capital gain [(1/2)($30,000)]	15,000
Income Increase	$249,000

27. B. The Taxable Income is the same amount for Maria and the Meryk trust.

28. A. Mandeep will have a taxable capital gain of $77,500 and will have attributed interest income of $7,000.

29. A. Aida has acquired a capital interest in the trust, and her ACB will be $350,000. Fatima will report a taxable capital gain of $112,500. {[1/2][$350,000 – (50%)($250,000)]}

30. B. $8,921 [(33%)($40,000) – (15%)($40,000 - $11,474)]

31. C. The trust will be subject to lower tax rates, and can be used to split income with the settlor.

32. B. To allow future appreciation in a valuable asset or assets to appreciate for the benefit of specific related parties.

33. B. A transfer of capital assets with accrued gains to a corporation using ITA 85.

34. B. The use of ITA 85 does not require a corporation to be in place prior to the freeze.

TIF Solution Nineteen - 4

Exam Exercise Solution Nineteen - 1 (Establishing A Trust)

Case A While Martin has signed the agreement, it does not appear that the property has been transferred. This means that no trust has been created.

Case B "Prison inmates in Virginia" cannot be considered to be an identifiable class. As a consequence, there is no certainty as to beneficiaries and no trust would be created by her transfer.

Case C While Ms. Morgan has transferred property, it is not clear that her intention was to create a trust. No trust would be created by this transfer.

Exam Exercise Solution Nineteen - 2 (Basic Taxation Of Trusts)

With respect to Jerry's transfer of his securities to the trust, the transaction would be deemed to take place at fair market value. This would result in a taxable capital gain to Jerry of $25,000 [(1/2)($570,000 - $520,000)]. There would be no tax consequences to James or the trust as a result of this transfer.

As the trust distributed all of its income during the year, none of the interest would be taxed in the trust. All of the interest would be included in James' income and, because he is an adult, there would be no income attribution to Jerry.

Under ITA 107(2), the transfer from the trust to James on January 1, 2017 would take place at the trust's tax cost of $570,000. There would be no tax consequences for Jerry, James, or the trust as a result of this transfer. However, as James' adjusted cost base is $570,000, the sale at the fair market value of $615,000 would result in a taxable capital gain of $22,500 [(1/2)($615,000 - $570,000)].

Exam Exercise Solution Nineteen - 3 (Basic Taxation Of Trusts With Income Attribution)

When Martha transfers the securities to the trust in 2016, she will recognize a taxable capital gain of $75,000 [(1/2)($500,000 - $350,000)].

With respect to the eligible dividends, as Jane is under 18 years of age, they will be attributed back to Martha. This will result in an income inclusion of $69,000 [($50,000)(138%)] and provide Martha with a federal dividend tax credit of $10,364 [(6/11)(38%)($50,000)].

The securities will be transferred to Jane at an adjusted cost base of $500,000. This means that, when she sells them, she will record a taxable capital gain of $25,000 [(1/2)($550,000 - $500,000)]. Note that there is no income attribution of the capital gains.

Exam Exercise Solution Nineteen - 4 (Transfer To Common-Law Partner Trust)

As there is a rollover available on transfers to a qualifying common-law partner trust, the accrued $303,000 gain ($723,000 - $420,000) will not be recognized until his common-law partner or the common-law partner trust eventually disposes of the portfolio. The common-law partner trust acquires the portfolio at an adjusted cost base of $420,000, which will be David's adjusted cost base if the trust transfers the portfolio to him.

Exam Exercise Solution Nineteen - 5 (Transfer To Common-Law Partner Trust)

As a rollover is available on transfers to a qualifying common-law partner trust, there would be no tax consequences for Lara at the time of the transfer. However, the adjusted cost base of the securities in the trust would be $675,000, Lara's adjusted cost base.

The securities would be transferred out of the trust to Portia at the same $675,000 value. This means that when she sells the securities for $950,000, she will have a taxable capital gain of $137,500 [(1/2)($950,000 - $675,000)].

While this is not required by the problem, you should note that, unless the testamentary trust is designated a graduated rate estate, any income that is left in the trust will be taxed at the maximum rate of 33 percent.

Exam Exercise Solution Nineteen - 6 (Transfers To Trusts)

In those cases where a taxable capital gain will be recognized at transfer, the amount of the gain will be $200 [(1/2)($2,500 - $2,100)].

Scenario	Taxable Capital Gain (Settlor)	Adjusted Cost Base (Trust)
1. Inter vivos trust for adult child	$200	$2,500
2. Testamentary spousal trust	Nil	2,100
3. Joint common-law partner trust	Nil	2,100
4. Inter vivos qualifying spousal trust	Nil	2,100
5. Inter vivos trust for minor child	200	2,500
6. Testamentary trust for friend	200	2,500
7. Alter ego trust	Nil	2,100

Exam Exercise Solution Nineteen - 7 (Transfers To Trusts)

In those cases where a taxable capital gain will be recognized at transfer, the amount of the gain will be $5,000 [(1/2)($30,000 - $20,000)].

Scenario	Taxable Capital Gain (Settlor)	Adjusted Cost Base (Trust)
1. Joint spousal trust	Nil	$20,000
2. Inter vivos trust for business partner	$5,000	30,000
3. Testamentary trust for 22 year old son	5,000	30,000
4. Testamentary qualifying spousal trust	Nil	20,000
5. Alter ego trust	Nil	20,000
6. Inter vivos trust for a minor child	5,000	30,000

Exam Exercise Solution Nineteen - 8 (Spousal Trusts And Income Allocation)

Transfer At Death Because of the available rollover to a qualifying spousal trust, the trust will be deemed to have acquired the depreciable asset at a capital cost of $224,000 and UCC of $147,200. The $76,800 difference between the capital cost and the UCC would be deemed to be CCA. The fair market value at Mark's death is not relevant to the transfer.

Sale By Trust The tax consequences of the sale by the trust would be calculated as follows:

Proceeds Of Disposition	$243,200
Capital Cost	(224,000)
Capital Gain	$ 19,200
Inclusion Rate	1/2
Taxable Capital Gain	$ 9,600

Capital Cost	$224,000
UCC At Sale ($147,200 - $15,400)	(131,800)
Recapture Of CCA	$ 92,200

All of the income from the sale can be allocated to Mark's spouse. This would be the taxable capital gain of $9,600 and the recaptured CCA of $92,200. As a result, the trust would have nil Tax Payable.

Exam Exercise Solution Nineteen - 9 (Spousal Trusts And Income Allocation)

Transfer At Death Because of the available rollover to a qualifying spousal trust, the trust will be deemed to have acquired the depreciable asset at a capital cost of $150,000 and UCC of $140,000. The $10,000 difference between the capital cost and the UCC would be deemed to be CCA. The fair market value at Martine's death is not relevant to the transfer.

Sale By Trust The tax consequences of the sale by the trust would be calculated as follows:

Proceeds Of Disposition	$205,000
Capital Cost	(150,000)
Capital Gain	$ 55,000
Inclusion Rate	1/2
Taxable Capital Gain	$ 27,500

Capital Cost	$150,000
UCC At ($140,000 - $20,000)	(120,000)
Recapture Of CCA	$ 30,000

All of the income from the sale can be allocated to Martine's spouse. This would be the taxable capital gain of $27,500 and the recaptured CCA of $30,000. As a result, the trust would have nil Tax Payable.

Exam Exercise Solution Nineteen - 10 (Flow Through To Beneficiaries)

The income allocation would be as follows:

	Received By Trust	Paid To Francine	Retained By Trust
Eligible Dividends	$367,000	$210,000	$157,000
Non-Eligible Dividends From CCPC	108,000	108,000	Nil
Capital Gain	47,000	47,000	Nil
Totals	$522,000	$365,000	$157,000

The Net Income For Tax Purposes of the trust would be calculated as follows:

Eligible Dividends	$157,000
Gross Up Of Eligible Dividends At 38 Percent	59,660
Net Income For Tax Purposes - Trust	$216,660

The Net Income For Tax Purposes for Francine would be as follows:

Eligible Dividends From Canadian Corporations	$210,000
Gross Up At 38 Percent	79,800
Non-Eligible Dividends From CCPC	108,000
Gross Up At 17 Percent	18,360
Taxable Capital Gains [(1/2)($47,000)]	23,500
Net Income For Tax Purposes - Francine	$439,660

The dividend tax credit that will be available to the trust is $32,542 [(6/11)($59,660)]. Francine's dividend tax credits will be $43,527 [(6/11)($79,800)] on the eligible dividends and $13,295 [(21/29)($18,360)] on the non-eligible amounts.

Exam Exercise Solution Nineteen - 11 (Flow Through To Beneficiaries)

The income allocation would be as follows:

	Received By Trust	Paid To Marcin	Retained By Trust
Eligible Dividends	$ 50,000	$ 37,500	$12,500
Non-Eligible Dividends From CCPC	200,000	150,000	50,000
Capital Gain	30,000	22,500	7,500
Totals	$280,000	$210,000	$70,000

The Net Income For Tax Purposes of Marcin and the trust would be calculated as follows:

	Marcin	Trust
Eligible Dividends	$37,500	$12,500
Gross-Up On Eligible Dividends At 38%	14,250	4,750
Non-Eligible Dividends	150,000	50,000
Gross-Up On Non-Eligible Dividends At 17%	25,500	8,500
Capital Gain	22,500	7,500
Non-Taxable Half Of Capital Gain	(11,250)	(3,750)
Net Income for Tax Purposes	$238,500	$ 79,500

Exam Exercise Solution Nineteen - 12 (Inter Vivos Trusts - Tax Payable)

Taxable Income and federal Tax Payable for the trust would be calculated as follows:

Non-Eligible Dividends Received	$35,500
Deduction For Distribution To Beneficiary	(24,500)
Net Dividend Income	$11,000
Dividend Gross Up (17 Percent)	1,870
Taxable Income For The Trust	$12,870
Federal Tax Rate (Inter Vivos Trust)	33%
Federal Tax Before Credits	$ 4,247
Federal Dividend Tax Credit [(21/29)($1,870)]	(1,354)
Federal Tax Payable - Trust	$ 2,893

Taxable Income and federal Tax Payable for the son would be calculated as follows:

Non-Eligible Dividend Income From The Trust	$24,500
Dividend Gross Up (17 Percent)	4,165
Taxable Income For The Son	$28,665
Federal Tax Rate	15%
Federal Tax Before Credits	$ 4,300
Basic Personal Credit [(15%)($11,474)]	(1,721)
Federal Dividend Tax Credit [(21/29)($4,165)	(3,016)
Federal Tax Payable - Son	Nil

Although not required, you might note that, if all of the dividends had been distributed to the son, his tax liability would have only been $139. By leaving $11,000 in dividends in the trust, $2,754 ($2,893 - $139) in avoidable taxes were paid.

Exam Exercise Solution Nineteen - 13 (Inter Vivos Trusts - Tax Payable)

The required calculations are as follows:

Eligible Dividends Received	$100,000
Gross-Up On Eligible Dividends [($100,000)(38%)]	38,000
Net Income for Tax Purposes and Taxable Income - Trust	$138,000
Flat Rate For Inter Vivos Trusts	33%
Tax Before Credits	$ 45,540
Dividend Tax Credit [(6/11)($38,000)]	(20,727)
Federal Tax Payable - Trust	$ 24,813

Exam Exercise Solution Nineteen - 14 (Testamentary Trusts - Tax Payable)

As this is a graduated rate estate, the calculation of its Tax Payable will be based on the same graduated rate schedule that is used by individuals.

The Net Income for Tax Purposes and Taxable Income for both Marta and the trust would be the same as the dividends received are allocated 50:50. The required calculations are as follows:

Non-Eligible Dividends [(50%)($200,000)]	$100,000
Gross-Up On Non-Eligible Dividends [($100,000)(17%)]	17,000
Net Income for Tax Purposes and Taxable Income	$117,000

The federal Tax Payable for Marta and the trust would be calculated as follows:

	Marta	Trust
Tax On First $90,563	$16,075	$16,075
26 Percent Of $26,437		
($117,000 - $90,563)	6,874	6,874
Tax Payable Before Credits	$22,949	$22,949
Basic Personal Credit [(15%)($11,474)]	(1,721)	N/A
Age Credit [(15%)($7,125)]	(1,069)	N/A
Dividend Tax Credit [(21/29)($17,000)]	(12,310)	(12,310)
Federal Tax Payable	$ 7,849	$ 10,639

Exam Exercise Solution Nineteen - 15 (Income Attribution)

Income on the bonds is subject to the attribution rules to the extent that the income is allocated to Martine's spouse, Michael, or to their minor daughter, Rachel. This means that two-thirds of the interest will be attributed back to Martine. With respect to the capital gain, the attribution rules do not apply on transfers to minors. This means that only Michael's one-third share of the gain will be attributed back to Martine.

The increase in Taxable Income for Martine and the trust's beneficiaries are calculated as follows:

	Michael	Rachel	Dirk	Attributed To Martine
Interest Income ($108,000 ÷ 3)	$36,000	$36,000	$36,000	Nil
Interest Attribution To Martine	(36,000)	(36,000)	Nil	$72,000
Taxable Capital Gain				
[(1/2)($36,000) ÷ 3]	6,000	6,000	6,000	Nil
Capital Gain Attribution To Martine	(6,000)	Nil	Nil	6,000
Increase In Taxable Income	Nil	$6,000	$42,000	$78,000

Exam Exercise Solution Nineteen - 16 (Income Attribution)

The dividend income is subject to the attribution rules to the extent that the income is allocated to Devon's spouse, Connie, and to their minor son, Marvin. This means that two-thirds of the dividends will be attributed back to Devon. As well, Connie's share of the taxable capital gain is attributed back to Devon.

The increase in Taxable Income for Devon and the trust's beneficiaries are calculated as follows:

	Connie	Marvin	Diane	Attributed To Devon
Eligible Dividends ($72,900 ÷ 3)	$24,300	$24,300	$24,300	Nil
Dividend Attribution To Devon	(24,300)	(24,300)	Nil	$48,600
Net Dividends	Nil	Nil	$24,300	$48,600
Dividend Gross Up At 38 Percent	Nil	Nil	9,234	18,468
Taxable Capital Gain [(1/2)($16,200) ÷ 3]	2,700	2,700	2,700	Nil
Capital Gain Attribution To Devon	(2,700)	Nil	Nil	2,700
Increase In Taxable Income	Nil	$ 2,700	$36,234	$69,768

Exam Exercise Solution Nineteen - 17 (Sale Of A Capital Interest)

With respect to Sarah, she has acquired a capital interest for consideration of $204,500. This will be the adjusted cost base of the interest she has acquired.

With respect to Mary, she has disposed of a capital asset for proceeds of disposition of $204,500. Since she did not purchase the interest in the trust, her adjusted cost base as usually determined would be nil. However, for this disposition, the adjusted cost base of the capital interest is the greater of nil and the cost amount as determined under ITA 108(1). The cost amount would be $156,000, one-half of the $312,000 tax cost of the assets in the trust. The result would be a taxable capital gain of $24,250 [(1/2)($204,500 - $156,000)].

Exam Exercise Solution Nineteen - 18 (Sale Of A Capital Interest)

Billy has acquired a capital interest for consideration of $210,000. This would be the adjusted cost base of his interest.

Correspondingly, Bart has disposed of his capital interest for consideration of $210,000. This would be his proceeds of disposition. His adjusted cost base as usually determined would be nil. However, for this disposition, the adjusted cost base of the capital interest is the greater of nil and the cost amount as determined under ITA 108(1). This cost amount would be $150,000 [(1/2)($300,000)]. Given this, Bart will have a taxable capital gain of $30,000 [(1/2)($210,000 - $150,000)].

Exam Exercise Solution Nineteen - 19 (Family Trusts)

As Fred's other income places him in the maximum federal tax bracket of 33 percent, his federal tax savings resulting from transferring the assets to the family trust would be $49,500 [($150,000)(33%)]. The federal tax that would be payable on the additional $50,000 received by each of the triplets is as follows:

Tax On First $45,282	$6,792
Tax On Additional $4,718 ($50,000 - $45,282) At 20.5 Percent	967
Tax Before Credit	$7,759
Personal Credit [(15%)($11,474)]	(1,721)
Federal Tax Payable	$6,038

The total tax paid by the triplets would be $18,114 [($6,038)(3)]. This is $31,386 ($49,500 - $18,114) per year less in federal taxes than the amount that would be paid by Fred without the trust.

Exam Exercise Solution Nineteen - 20 (Family Trusts)

With her employment income in excess of $250,000, any additional income that is received by Darlene will be taxed at a federal rate of 33 percent. This means that, on $120,000 of interest income, she would pay federal taxes of $39,600 [(33%)($120,000)].

If she establishes the family trust, each of her sons will receive income of $60,000. The federal Tax Payable on this amount would be calculated as follows:

Tax On First $45,282	$ 6,792
Tax On Additional $14,718 ($60,000 - $45,282) At 20.5 Percent	3,017
Tax Before Credit	$9,809
Personal Credit [(15%)($11,474)]	(1,721)
Federal Tax Payable	$ 8,088

The total tax paid by the sons would be $16,176 [(2)($8,088)]. This is $23,424 ($39,600 - $16,176) less than the federal taxes that Darlene would have paid on the $120,000 of interest income if received by her.

TIF Solution Nineteen - 5A

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

A. 9

B. 1

C. 2

D. 6

E. 7

F. 8

G. 4

H. 10

The two unused definitions are as follows:

Executor = 5

Inter Vivos Trust = 3

TIF Solution Nineteen - 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

B. 1 (not 11)

C. 3 (not 13)

D. 7 (not 2)

E. 8

F. 10

G. 5 (not 9)

H. 14

The two unused definitions are as follows:

Executor = 6

Inter Vivos Trust = 4

TIF Solution Nineteen - 6

Case A

1. The settlor has deemed proceeds of disposition of the fair market value of $26,400, and will record a taxable capital gain of $1,550 [(1/2)($26,400 - $23,300)]. In addition, there will be recapture of CCA of $7,900 ($23,300 - $15,400).

2. The trust acquires the property at a deemed capital cost of $26,400. However, for purposes of calculating CCA and recapture, the ITA 13(7)(e) rules for non-arm's length transactions apply and the value will be $24,850 [$23,300 + (1/2)($26,400 - $23,300)].

Case B

1. The settlor has deemed proceeds of disposition of the fair market value of $15,200. This would result in the settlor having recapture of $2,800 ($15,200 - $12,400).

2. The asset would be recorded in the trust records at the settlor's capital cost of $19,500, with deemed CCA of $4,300, resulting in a UCC of $15,200.

3. When the asset is transferred to the capital beneficiary, the deemed proceeds to the trust will be the UCC at the date of distribution of $13,600, resulting in no gain or loss on the transfer. The beneficiary will be deemed to have acquired the property for the UCC amount of $13,600. However, the beneficiary will have a capital cost of $19,500 for subsequent recapture and capital gains calculation purposes.

Case C

1. Under the general ITA 70(6) rollover provision, the deemed proceeds to the decedent would be the property's cost of $18,200, resulting in no gain or loss on the transfer. As the deceased has net capital loss carry forwards, a better alternative would be to elect out of ITA 70(6) and transfer the property at its fair market value of $76,400. The loss carry forwards could then be used to eliminate taxation on the resulting taxable capital gain of $29,100 [(1/2)($76,400 - $18,200)].

   Note that in the year of death, net capital loss carry forwards can be deducted against any type of income. If the decedent has other income against which the net capital loss carry forward can be deducted, it may not be advantageous to elect out of the rollover. More information on the spouse's current and future taxable income would be needed to optimize the use of the net capital loss carry forward.

2. Under the general ITA 70(6) rollover provision, the trust would record the property at the decedent's cost of $18,200. If the fair market value election is made, the spousal trust will have acquired the property at a deemed cost of $76,400. This higher value will serve to reduce any future gain on the property when it is sold.

Case D

1. The settlor has deemed proceeds of disposition of the fair market value of $123,200 and will record a taxable capital gain of $18,900 [(1/2)($123,200 - $85,400)].

2. The trust will record the property at a deemed cost equal to the fair market value of $123,200.

Case E

1. The settlor has deemed proceeds of disposition of the fair market value of $51,600 and will record a taxable capital gain of $4,200 [(1/2)($51,600 - $43,200)].

2. The asset would be recorded in the trust records at the fair market value of $51,600.

3. When the asset is transferred to the capital beneficiary, the deemed proceeds to the trust will be the carrying value of $51,600, resulting in no gain or loss on the transfer. The beneficiary will be deemed to have acquired the property at a cost of $51,600.

Case F

1. The deemed proceeds for the settlor would be the tax cost of $14,200, resulting in no gain or loss on the transfer.

2. The trust acquires the property at a deemed cost of $14,200.

TIF Solution Nineteen - 7

A trust can be used to split income in these circumstances. However, there are complications. First, as this is an inter vivos trust, any income that remains in the trust will be taxed at the maximum federal rate. Since this is the same rate that is applicable to Genevieve, there is little point in transferring property to the trust without distributing all of the income to lower income individuals.

There is no problem with allocating trust income to Genevieve's daughter, Lisa, as she is over 17 years old. As she has no other source of income, there would be significant tax savings, even if the entire $40,000 was allocated to her. However, as Philip is under 18, any trust allocations made to him will be attributed back to Genevieve. This means that there is no immediate tax advantage associated with income allocated to Philip. Note, however, there is a long run advantage in that, when the attributed earnings are reinvested, there is no attribution with respect to the compound earnings resulting from this reinvestment.

These considerations make it clear that, if a trust is going to be used, all of the income should be paid, or made payable, to Lisa, at least until Philip reaches 18 years of age. If the $40,000 exceeds the amount that Genevieve wishes Lisa to receive, the amount of property transferred to the trust could be reduced.

With Lisa attending university in the U.S., it is likely that she will require at least the full $40,000 to cover tuition, books, and living expenses. Given this, there would be excellent tax benefits associated with allocating the full $40,000 of trust income to Lisa, at least for the period of time that she is in university. The allocated income could be used to pay for her university costs, with the related tax credits and her personal tax credits eliminating most, or all, of the taxation on the full $40,000. Since Genevieve does not wish Lisa to receive cash from the trust, the trust could pay for her tuition and living costs directly.

Given the fact that it is not currently tax efficient to allocate income to Philip, Genevieve may wish to establish a discretionary trust. This would allow her to change the pattern of distributions once Philip reaches 18 years of age. At that time, it might be possible to use the trust to support his university education.

As the trust life is expected to extend beyond 21 years (until Philip turns 35), a deemed disposition of all trust assets will occur in 21 years. If the trust continues to invest in term deposits or similar investments, the deemed disposition will not be onerous. However, if the trust invests in securities that have unrealized capital gains, this rule would require recognition of these gains.

TIF Solution Nineteen - 8

Part A - Calculation Of Taxable Income

All amounts are allocated 45 percent to Jessica Jurgens, 40 percent to Joseph Jurgens, and 15 percent to the trust. The Taxable Income of the two beneficiaries and the trust would be calculated as follows:

	Jessica (45%)	Joseph (40%)	Trust (15%)
Interest On GICs	$ 56,700	$ 50,400	$ 18,900
Eligible Dividends Received	207,900	184,800	69,300
Gross Up Of 38 Percent	79,002	70,224	26,334
Taxable Capital Gain On Land [(1/2)($250,000 - $85,000)]	37,125	33,000	12,375
Taxable Capital Gain On Building [(1/2)($962,000 - $725,000)]	53,325	47,400	17,775
Net Rental Income (Note)	63,000	56,000	21,000
Net And Taxable Income	$497,052	$441,824	$165,684

Note The net rental income, including the recapture of CCA, can be calculated as follows:

Revenues From Rental Property		$125,000
Cash Expenses On Rental Property		(83,000)
Recapture Of CCA:		
Capital Cost Of The Building	$725,000	
UCC	(627,000)	98,000
Net Rental Income, Including Recapture		$140,000

Part B - Tax Payable For The Trust

The federal Tax Payable for the trust is as follows:

Federal Tax Before Credits [(33%)($165,684)]	$54,676
Federal Dividend Tax Credit [(6/11)($26,334)]	(14,364)
Federal Tax Payable	$40,312

As this trust is an inter vivos trust, all of its income is subject to federal tax at 33 percent [ITA 122(1)].

TIF Solution Nineteen - 9

Part A - Increase In Net Income For Tax Purposes

As a consequence of her death, there would be a deemed disposition of her capital property, resulting in the following increase in her Net Income For Tax Purposes:

Capital Gain On Public Company Shares ($2,156,000 - $1,420,000)	$ 736,000
Capital Gain On Government Of Canada Bonds	Nil
Capital Gain On Land ($787,000 - $622,000)	165,000
Capital Gain On Building ($1,230,000 - $850,000)	380,000
Total Capital Gains	$1,281,000
Inclusion Rate	1/2
Taxable Capital Gains	$ 640,500
Recapture On Building ($850,000 - $684,000)	166,000
Increase In Net Income For Tax Purposes	$ 806,500

Part B - Taxable Income For The GRE, Mac, And Muff

The allocations required by the will are as follows:

	Mac (30%)	Muff (40%)	GRE (30%)
Eligible Dividends Received	$25,500	$34,000	$25,500
Gross Up Of 38 Percent	9,690	12,920	9,690
Interest On Bonds	5,100	6,800	5,100
Net Rental Income ($77,550)	23,265	31,020	23,265
Discretionary Distribution	N/A	25,000	(25,000)
Net And Taxable Income	$63,555	$84,740	$63,555

Part C - Federal Tax Payable For The GRE

Income that remains in a GRE is taxed in the same general manner as would be applicable to an individual. However, the GRE would not be able to use personal tax credits under ITA 118 to reduce the amount of Tax Payable.

Federal Tax Payable for the trust would be calculated as follows:

Tax Payable On First $45,282	$6,792
Federal Tax On Next $18,273 ($63,555 - $45,282) At 20.5 Percent	3,746
Federal Tax Payable Before Credits	$10,538
Federal Dividend Tax Credit [(6/11)($9,690)]	(5,285)
Federal Tax Payable - GRE	$ 5,253

TIF Solution Nineteen - 10

Calculations

Taxable Income for the trust and for Mark would be calculated as follows:

	Trust	Mark
Interest Income	Nil	$18,500
Taxable Capital Gains:		
[($43,000)(1/2)(20%)]	$ 4,300	
[($43,000)(1/2)(80%)]		17,200
Eligible Dividends Received:		
[($32,000)(20%)]	6,400	
[($32,000)(80%)]		25,600
Gross Up On Dividends:		
[($32,000)(38%)(20%)]	2,432	
[($32,000)(38%)(80%)]		9,728
Net Rental Income:		
[($19,500)(20%)]	3,900	
[($19,500)(80%)]		15,600
Taxable Income	$17,032	$86,628

The Tax Payable for the trust would be calculated as follows:

Taxable Income	$17,032
Federal Tax Rate (Inter Vivos Trust)	33%
Federal Tax Payable Before Dividend Tax Credit	$ 5,621
Dividend Tax Credit [(6/11)($2,432)]	(1,327)
Federal Tax Payable - Trust	$ 4,294

The Tax Payable for Mark would be calculated as follows:

Tax On First $45,282		$ 6,792
Tax On Next $41,346 ($86,628 - $45,282) At 20.5 Percent		8,476
Federal Tax Before Credits		$15,268
Tax Credits:		
Personal	($11,474)	
Tuition	(12,500)	
Education [($400)(12)]	(4,800)	
Textbook [($65)(12)]	(780)	
	($29,554)	
Rate	15%	(4,433)
Dividend Tax Credit [(6/11)($9,728)]		(5,306)
Federal Tax Payable - Mark		$ 5,529

Comment

The $17,032 of income that was retained in the trust was taxed at a federal rate of 33 percent, before consideration of the dividend tax credit. If the income had been distributed to Mark, it would have been taxed at 20.5 percent, before consideration of the dividend tax credit, resulting in a $2,129 [($17,032)(33% - 20.5%)] reduction in federal Tax Payable. Based on tax considerations only, retention of the income in the trust was not advantageous.

TIF Solution Nineteen - 11

Part A - Increase In Net Income For Tax Purposes

As a consequence of her death, there would be a deemed disposition of her capital property, resulting in the following increase in Net Income For Tax Purposes:

Capital Gain On Public Company Shares ($2,342,000 - $1,856,000)	$486,000
Capital Gain On Government Of Canada Bonds	Nil
Capital Gain On Land ($989,000 - $865,000)	124,000
Capital Gain On Building ($1,560,000 - $1,250,000)	310,000
Total Capital Gains	$920,000
Inclusion Rate	1/2
Taxable Capital Gains	$460,000
Recapture On Building ($1,250,000 - $932,000)	318,000
Increase In Net Income For Tax Purposes	$ 778,000

Note The ITA 13(7)(e) provision which limits the capital cost of the asset for CCA purposes to the transferor's cost, plus one-half of any capital gain that results from the transfer, does not apply to non-arm's length transfers of depreciable property on death.

Part B - Taxable Income Of The GRE And Its Beneficiaries

The allocations required by the will are as follows:

	Marilyn (35%)	Murphy (45%)	GRE (20%)
Eligible Dividends Received ($123,670)	$ 43,284	$ 55,652	$24,734
Gross Up Of 38 Percent ($46,995)	16,448	21,148	9,399
Interest On Bonds ($22,490)	7,872	10,121	4,498
Net Rental Income ($100,910)	35,319	45,410	20,182
Net And Taxable Income	$102,923	$132,331	$58,813

Part C - Federal Tax Payable For The GRE

Income that remains in a GRE is taxed in the same general manner as would be applicable to an individual. However, the GRE would not be able to use personal tax credits under ITA 118 to reduce the amount of Tax Payable.

Federal Tax Payable for the GRE would be calculated as follows:

Federal Tax Payable On First $45,282	$6,792
Federal Tax Payable On Next $13,531 ($58,813 - $45,282) At 20.5 Percent	2,774
Federal Tax Payable Before Credits	$9,566
Federal Dividend Tax Credit [(6/11)($9,399)]	(5,127)
Federal Tax Payable - GRE	$4,439

Chapter Twenty Test Item File Solutions

TIF Solution Twenty - 1

1. The required two items can be selected from the following:
   - Prevention of double taxation.
   - Provision of income tax certainty.
   - Prevention of discrimination.
   - Implementing a proper division of cross-border revenues.
   - Provision of an information-sharing mechanism.

2. As stated in the text, residence is the cornerstone of Canadian income taxation. If a person is considered a resident of Canada in a given year, that person will be subject to Canadian income tax for that year on all sources of income. Alternatively, if the person is a non-resident, Canadian Part I tax will only apply to Canadian employment income, Canadian business income, and gains on the disposition of Taxable Canadian Property.

3. As stated in S5-F1-C1, the primary factors that will be considered by the CRA are as follows:
   - Whether the individual is continuing to maintain a dwelling in Canada.
   - Whether the spouse or common-law partner of the individual remains in Canada.
   - Whether the individual has dependants who remain in Canada.

4. The main factors here would be:
   - Does the individual have a dwelling in Canada?
   - Does the individual's spouse or common-law partner live in Canada?
   - Do the dependants of the individual live in Canada?

   Other factors that could be mentioned include:
   - Owning personal property in Canada (such as furniture, clothing, automobiles, and recreational vehicles).
   - Social ties with Canada (such as memberships in Canadian recreational and religious organizations).
   - Economic ties with Canada (such as employment with a Canadian employer and active involvement in a Canadian business, and Canadian bank accounts, retirement savings plans, credit cards, and securities accounts).
   - Hospitalization and medical insurance coverage from a province or territory of Canada.
   - A driver's license from a province or territory of Canada.
   - A vehicle registered in a province or territory of Canada.
   - A seasonal dwelling place in Canada or a leased dwelling place.
   - Holding a Canadian passport.
   - Membership in Canadian unions or professional organizations.

5. As noted in the text, S5-F1-C1 identifies the following factors:

   Intent The issue here is whether the individual intended to permanently sever residential ties with Canada. If, for example, the individual has a contract for employment, if and when he returns to Canada, this could be viewed as evidence that he did not intend to permanently depart. Another factor would be whether the individual complied with the rules related to permanent departures (i.e., as noted in Chapter 8, there is a deemed disposition of an individual's property at the time of departure from Canada, resulting in the need to pay taxes on any gains).

   Frequency Of Visits If the individual continues to visit Canada on a regular and continuing basis, particularly if other secondary residential ties are present, this would suggest that he did not intend to permanently depart from Canada.

Residential Ties Outside Of Canada A further consideration is whether or not the individual establishes residential ties in another country. If someone leaves Canada and travels for an extensive period of time without settling in any one location, it will be considered as evidence that he has not permanently departed from Canada.

6. A Canadian resident normally becomes a non-resident on the latest of the following days:
   - on leaving Canada,
   - when a spouse and/or dependants leave Canada, and
   - on becoming a resident of another country.

7. As a sojourner, Jane would be assessed Canadian income taxes on her world wide income for the entire year. As she would not be considered a resident of a province, she would be assessed an additional federal income tax of 48 percent of her basic federal tax otherwise payable.

   In contrast, Jack would only be assessed Canadian income taxes on his world wide income for the 210 day period prior to his departure from Canada. In addition, he would be assessed provincial income tax in the province of Manitoba for this 210 day period.

8. The required three items could be selected from the following:

   Permanent Home If the individual has a permanent home available in only one country, the individual will be considered a resident of that country. A permanent home means a dwelling, rented or purchased, that is continuously available at all times. For this purpose, a home that would only be used for a short duration would not be considered a permanent home.

   Centre of Vital Interests If the individual has permanent homes in both countries, or in neither, then this test looks to the country in which the individual's personal and economic relations are greatest. Such relations are virtually identical to the ties that are examined when determining factual residence for individuals.

   Habitual Abode If the first two tests do not yield a determination, then the country where the individual spends more time will be considered the country of residence.

   Citizenship If the tie-breaker rules still fail to resolve the issue, then the individual will be considered a resident of the country where the individual is a citizen.

   Competent Authority If none of the preceding tests resolve the question of residency then, as a last resort, the so-called "competent authority procedures" are used. Without describing them in detail, these procedures are aimed at opening a dialogue between the two countries for the purpose of resolving the conflict.

9. If an enterprise is incorporated in Canada after April 26, 1965, it will always be considered resident in Canada. However, if it is incorporated in Canada prior to April 27, 1965, it will only be considered resident in Canada in those situations where it either:
   - carried on business in Canada at any time after that date; or
   - was resident in Canada at any time after that date (as measured by the location of the mind and management of the corporation).

10. Limon Inc. is a U.S. resident because it was incorporated in that country. It is also a Canadian resident under the mind and management test. In such dual residency cases, the tie-breaker rule in the Canada/U.S. tax treaty indicates that the taxes will be assessed in the country of incorporation. That means that Limon Inc. would be subject to U.S. income taxes.

11. Non-residents are subject to Canadian Part I taxes on:
    - employment income earned in Canada;
    - income earned while carrying on a business in Canada; and
    - gains resulting from dispositions of Taxable Canadian Property.

12. As described in the text, the exceptions are as follows:

    $10,000 Rule Under this rule if, during a calendar year, a U.S. resident earns employment income in Canada that is $10,000 or less in Canadian dollars, then the income is taxable only in the U.S.

    183 Day Rule This rule exempts Canadian source employment income from Canadian taxation, provided it is earned by a U.S. resident who was physically present in Canada for no more than 183 days during any twelve month period commencing or ending in the calendar year. This exemption is conditional on employment income not being paid by an employer with a permanent establishment in Canada who would be able to deduct the amount paid from their Canadian Taxable Income. Stated alternatively, if the employment income exceeds $10,000 and is deductible in Canada, it will be taxed in Canada, even if the employee is present in Canada for less than 183 days during the year.

13. As described in the text, the situations are as follows:

- An individual who acts on behalf of a non-resident enterprise and who is authorized to conclude contracts in the name of that enterprise is considered a permanent establishment.
- An individual who acts on behalf of a business and meets both a physical presence test (183 days or more in any 12 month period beginning or ending in the year) and a gross revenue test (that more than 50% of the gross active business revenues of the U.S. business are from services performed by that individual during the period the individual is in Canada), is considered a permanent establishment.

14. The required two items can be selected from the following items that were covered in the text:
    - interest income
    - royalty income
    - rental income
    - dividend income
    - pension benefits

15. If she pays taxes under Part XIII, the taxes will generally be assessed at a 25 percent rate on her gross rents. Alternatively, if she elects to be taxed under Part I, the tax will only be assessed on her net rental income (gross rents, less expenses). Depending on her personal tax rate and the amount of rental expenses involved, this may be a desirable alternative. Also note that, if she makes this election, she cannot make deductions from Net Income For Tax Purposes in determining Taxable Income, and she cannot deduct her personal tax credits in the determination of Tax Payable.

16. An individual immigrating to Canada may own capital property on which there are accrued capital gains. If there was no deemed disposition/reacquisition at the time the individual enters Canada, a subsequent sale of property could result in tax being assessed on gains that accrued prior to the individual becoming a resident of Canada. This would not appear to be an equitable situation.

17. The most common reason for making this election would be a situation in which the individual has capital losses. This could be either net capital losses from previous years carried forward, or current year losses including those resulting from required deemed dispositions on departure. In this situation, the taxpayer may wish to trigger a gain on real estate that can be used to absorb these losses.

    Alternatively, if the fair market value of the real estate is less than its cost, the individual could make the election in order to use the capital loss on the required deemed disposition of other assets.

18. There would be a deemed disposition of his shares at the time of departure, resulting in his paying taxes on a taxable capital gain of $100,000 [(1/2)($500,000 - $300,000)]. On his return, if no election is made, the shares will have an adjusted cost base of $500,000.

    While this information is not required by the question, there is an election available to reverse the deemed disposition that resulted from his departure. If he makes this election, the taxable capital gain would be reversed and any taxes paid would be refunded. However, the adjusted cost base would revert to the original $300,000.

19. The full $20,000 in foreign source business income would be included in John's Taxable Income, with basic Canadian Tax Payable calculated on this amount. The $2,000 that was withheld can then be used in the calculation of the foreign business tax credit available to be applied against the Canadian Tax Payable.

20. Because Canadian corporations generally pay dividends out of income that has been subject to Canadian taxation at the corporate level, dividends received by Canadian residents from taxable Canadian corporations are given favourable tax treatment. This favourable tax treatment, based on gross up and tax credit procedures, significantly reduces the effective tax rate on this type of income.

    When dividends are received from non-resident corporations, this favourable treatment cannot be justified. The reason for this is that the non-resident corporation that paid the dividends has not paid Canadian taxes on the income that is the source of the dividends.

21. **Controlled Foreign Affiliates** Whether the resident Canadian shareholder is an individual or a corporation, Foreign Accrual Property Income (FAPI) that is earned by a Controlled Foreign Affiliate must be included in income on an accrual basis as it is earned. When these amounts are subsequently paid out as dividends they will be included in the income of the Canadian shareholder but will be eligible for an offsetting deduction to recognize the fact that the amount was previously taxed as FAPI. If the dividend is paid from non-FAPI sources of income, it will be included in income, but, in the case of Canadian corporate shareholders, may be completely or partially offset by the ITA 113(1) deduction from Taxable Income depending upon whether Canada has entered into a tax treaty or Tax Exchange Information Agreement (TEIA) with the source country. Canadian individual shareholders would obtain partial relief through the foreign tax credit system only, since they are not entitled to the ITA 113(1) deduction. This generally encourages individuals to hold shares in foreign corporations through a resident Canadian corporation.

    Non-Controlled Foreign Affiliates The income of Foreign Affiliates that are not controlled will not be accrued as it is earned. Rather, it is included in income when dividends are received from the Foreign Affiliate. If the dividend is paid from active business income earned in a country with which Canada has a tax treaty or TEIA, it will be eliminated by the ITA 113(1) deduction in the calculation of Taxable Income. In addition, dividends paid out of the non-taxable portion of some types of capital gains, or the full amount of capital gains resulting from dispositions of property used in an active business in a country with which Canada has a tax treaty or TEIA, are deductible under ITA 113(1). When the ITA 113(1) deduction is available, no credit can be taken for any foreign taxes paid.

    Alternatively, if the dividend is paid out of passive income, or earned in a

non-treaty/non-TEIA country, it will be included in income and only be eligible for deductions under ITA 113 to the extent income taxes or withholding taxes have been paid on the amounts distributed.

22. If the Canadian company undertakes to deliver the goods and provide the services required in the contract, the total profit will be taxed at full Canadian rates. This reflects the fact that Canadian corporations are taxed on their worldwide income. However, tax credits for any foreign taxes paid on that income would be available to Clarkson Equipment Ltd.

    If a separate subsidiary is established in the African country, the subsidiary can purchase the required manufactured items from Clarkson and potentially resell them at a profit. Additional profits could be engendered through the training operations. Any profits will be active business income and will not be deemed Foreign Accrual Property Income (FAPI). This means that there will be no Canadian taxation until such time as the earnings are repatriated into Canada and are paid as dividends to individual shareholders. If the corporate tax rates in the African country are lower than Canadian rates, forming the subsidiary may be advantageous.

TIF Solution Twenty - 2

1. True.

2. False. S5-F1-C1 makes it clear that the length of the period of time during which the individual is absent from Canada is not a determining factor with respect to residency.

3. False. Such part year residents will only be taxed on their world side income for the portion of the year prior to their moving to Canada.

4. True.

5. False. Regardless of the amount of Canadian income reported, some credits will be available to non-residents filing a Canadian tax return. Examples include EI and CPP tax credits, and the charitable donations tax credit.

6. True.

7. True.

8. False. Non-residents are not required to file a Canadian tax return for income that is subject to Part XIII tax.

9. False. The Canada/U.S. tax treaty states that interest arising in a contracting state and beneficially owned by a resident of the other contracting state may be taxed only in that other state.

10. True. While there will be a deemed disposition of all capital property, some items (e.g., real property situated in Canada) will exempted from recognizing capital gains on the disposition.

11. False. Whether the individual continues to maintain social ties is not one of the three most significant factors.

12. False. The length of the period of absence from Canada is not considered a factor in determining residency retention.

13. True. A part year resident for the current year is an individual who either establishes residency in Canada during the current year or, alternatively, terminates residency in Canada during the current year.

14. False. The 183 days do not have to be consecutive.

15. True. However, the Canada/U.S. tax treaty does provide two exceptions.

16. False. In general, such income is taxable in Canada as mining is deemed to be carrying on a business in Canada.

17. True.

18. False. Such facilities are not considered to be permanent establishments under the provisions of the Canada/U.S. tax treaty.

19. False. Only gains on dispositions of taxable Canadian property fall under ITA 2(3).

20. True.

21. False. Only interest on participating debt and exempt interest paid to non-arms' length non-residents is subject to Part XIII tax.

22. True. The rate applicable to U.S. residents is reduced to either 5 percent when the U.S. resident owns 10 percent or more of the voting shares, or to 15 percent in other situations.

23. True. This rule prevents Canadian taxation of capital gains that accrued while the immigrant was not a Canadian resident.

24. True.

TIF Solution Twenty - 3

New For 2016/2017

1. C. The individual has become a resident of another country.

2. D. Exeter Ltd. was incorporated in Alberta in 1956. However, it has never carried on business in Canada and its management has always been located in Montana.

3. B. A corporation that was incorporated in North Dakota but carries on all of its business in southern Manitoba.

4. C. A multinational manufacturing business that has a factory in Canada.

5. D. $46,000 ($72,000 - $6,000 - $20,000); $72,000

6. D. Shares of a CCPC that primarily owns rental properties for resale.

7. B. $177,500 ($130,000 + $50,000 - $2,500)

Retained From Previous Editions

Residence Of Individuals

8. D. She did not leave taxable Canadian property in Canada.

9. C. An individual who immigrates to Canada during the year is a resident of Canada for tax purposes for the full calendar year.

10. B. Bob, Charles, and Dick.

11. A. To be a resident for tax purposes, an individual must be a Canadian citizen.

12. A. The country in which the individual earns business income.

13. C. Jamal is considered a non-resident of Canada.

14. A. Ravi is a citizen of India, where he was born and lived until moving to Canada on March 1 of the current year. He was transferred by his employer to its Canadian head office.

15. B A non-resident

16. D A part-year resident

Residence Of Corporations And Individuals

17. B. It appears Karen has severed all ties with Canada.

18. B. $85,000 [$50,000 + $35,000]

19. B. $35,000 [$30,000 + $5,000]. The employment income is exempt from taxation in Canada as it is less than $10,000.

20. D. Helen is employed by a Canadian resident company in a foreign country. The tax treaty with the foreign country exempts her employment income from taxation.

21. D. Merivale is subject to Canadian tax on the income that is earned by the Calgary office.

22. B. Ku Jung owns a rental property in downtown Vancouver. Ku has owned the property for 3 years and has never lived in it. The property is sold for a substantial gain.

23. B a storage facility

24. C. Mr. O'Shea will be subject to Canadian Part I tax.

25. C. Interest on Government of Canada bonds.

26. B. Interest on a GIC issued by a Canadian bank.

27. A. The gross rents are subject to withholding under Part XIII of the *Income Tax Act*. However, the taxpayer can elect to file a Canadian tax return which will include the net rental income.

28. D. Interest paid on a savings account at a Canadian bank branch located in Canada

29. D. Ying, a resident of a country that does not have a tax treaty with Canada, earns $25,000 on a loan to Sun Enterprises Limited, a CCPC. Ying owns 40% of the shares in the company. Note that U.S. residents are not liable for Part XIII tax on interest.

30. C. Interest paid to an arm's length party

31. A. Mr. Winsome will be deemed to have disposed of his mutual funds, sailboat, TNX Co. shares, and Bell Canada shares on December 15, 2016.

32. C. There will be no tax consequences at the time of departure. However, any withdrawals from the plan after his departure will be subject to Canadian Part XIII tax.

33. B. There would be an allowable capital loss of $20,000.

34. D. All of the above.

TIF Solution Twenty - 4

Exam Exercise Solution Twenty - 1 (Residential Ties)

While the situation is not completely clear, it is likely that the CRA would conclude that Mr. Resner is no longer a Canadian resident. By retaining his residence, he has maintained one of the primary residential ties. However, the fact that he was not able to sell the property, accompanied by the long-term lease to a third party, would probably be sufficient evidence that this is not a significant residential tie. The retention of his membership in the Chartered Professional Accountants Association Of Alberta would be viewed as a secondary residential tie. However, it is unlikely that this tie would be sufficient to cause Mr. Resner to be viewed as a Canadian resident.

Exam Exercise Solution Twenty - 2 (Temporary Absences)

Mary did, in fact, sever most of her residential ties with Canada. This would suggest that she would not be considered a Canadian resident during the two years she worked in New York City. However, the fact that she returned frequently to visit her boyfriend might lead the CRA to assess her on the basis of being a Canadian resident during this period, but it is not clear that such an assessment would be successful.

Exam Exercise Solution Twenty - 3 (Temporary Absences)

While John severed the great majority of his residential ties with Canada, two factors would suggest that the CRA would likely view him as a Canadian resident during the 18 months that he is absent from the country:

- His frequent visits to spend time with his dog.
- Perhaps more importantly, the fact that he claimed a Canadian address to maintain access to the Ontario health care system would be viewed as a very significant factor.

While the answer is not clear cut, our opinion would be that these factors would lead to the conclusion he maintained his Canadian residency. Given the fact that he appears to be defrauding the Ontario health care system, he might be wise to avoid disputing his continued residency.

Exam Exercise Solution Twenty - 4 (Part Year Residence)

Melissa would be taxed on her worldwide income for the part of the year that she was resident in Canada. This would be the period January 1 through July 1, the date that her husband and children fly to the U.S. July 1 would be the latest of: the date that Melissa leaves Canada (March 15), the date that Melissa establishes U.S. residency (March 15), and the date that her husband and children depart Canada (July 1). It is unlikely that the fact that her house was not sold until a later date would influence her residence status.

Exam Exercise Solution Twenty - 5 (Part Year Residence)

For residency purposes, an individual is considered to have ceased being a resident of Canada at the latest of three dates:

1. The date the individual leaves Canada.
2. The date the individual's family leaves Canada.
3. The date the individual establishes residency in another country.

In Barton's case the latest of the dates would be July 1, 2017, the date on which he receives the required residency documents. Given this, Barton would be considered a Canadian resident for the entire 2016 taxation year. In addition, he would be a part year resident for the period January 1, 2017 through June 30, 2017.

Exam Exercise Solution Twenty - 6 (Individual Residency)

Under ITA 250(1)(c)(i), Mrs. Sothor would be a deemed Canadian resident because of her position as a Canadian ambassador and the fact that she was a Canadian resident at the time she was appointed to this post. As her husband is exempt from Tanzanian taxation due to his relationship to a deemed resident, he is a deemed resident of Canada under ITA 250(1)(g). Of her two children, the younger son would be a deemed resident under ITA 250(1)(f) as he is a Canadian ambassador's dependent child. However, the older son would not be a deemed resident because his income exceeds the base for the basic personal tax credit for 2016 of $11,474 and he would therefore not be considered a dependant.

Exam Exercise Solution Twenty - 7 (Individual Residency)

While Ms. Washton is the child of a Canadian High Commissioner, it appears that she is no longer a dependant of this individual. It would also appear that she has income in excess of the base for the basic personal tax credit for 2016 of $11,474. As a consequence, she would not be considered a deemed resident under ITA 250(1).

Exam Exercise Solution Twenty - 8 (Corporate Residency)

As the Company was incorporated in Canada after April 26, 1965, it would be deemed to be a Canadian resident under ITA 250(4). While the problem does not provide enough information to determine this, it is possible that the Company has dual residency with the country or countries where it does business. This could result in the application of one or more international tax treaties. Note that, in general, where a corporation does business is not relevant to the residency decision.

Exam Exercise Solution Twenty - 9 (Corporate Residency)

As Wolfhowl Ltd. was incorporated in Canada prior to April 27, 1965, it will only be considered to be a Canadian resident if it has carried on business in Canada or become a Canadian resident subsequent to April 26, 1965. As the director's meetings were held in Canada until 1971, this would suggest that the "mind and management" of the Company was in Canada during this period. This would make the Company a Canadian resident subsequent to April 26, 1965. However, as the mind and management of the corporation is in the United States, it would also be considered a resident of that country. In such dual residency situations, the Canada/U.S. tax treaty tie breaker rules indicate the Company will be considered a resident of the country of incorporation, which in this case would be Canada.

Exam Exercise Solution Twenty - 10 (Corporate Residency)

While Acton Enterprises was not incorporated in Canada, it would appear that the "mind and management" of the Company is now located in Canada. This means that the Company would be considered a Canadian resident for the 2016 taxation year. However, as it was incorporated in the U.S., it would also be considered a resident of that country. In such dual residency situations, the tie breaker rules indicate the residence would be based on the country of incorporation. This would mean that Acton Enterprises would not be a Canadian resident during 2016.

Exam Exercise Solution Twenty - 11 (Carrying On Business In Canada)

Case 1 Rawlings is not carrying on business in Canada and would not be subject to Canadian taxes.

Case 2 The tax treaty allows Canada to tax business income only if such income is attributable to a permanent establishment in Canada. The warehouse constitutes a fixed place of business regardless of whether it is owned or leased. However, since it appears to be used exclusively to maintain an inventory for delivery, it would be an excluded activity and would therefore not be considered to be a permanent establishment. A further consideration is the employee who sells the product. Since he is not allowed to conclude contracts without approval, he would not be considered to be a permanent establishment. Rawlings would not be taxable under ITA 2(3) on its Canadian profits.

Case 3 In this Case, because the employee has authority to conclude contracts on behalf of a non-resident enterprise, the employee is deemed to be a permanent establishment. This means that Rawlings is taxable in Canada under ITA 2(3) on its business profits attributable to the permanent establishment (i.e., the employee).

Exam Exercise Solution Twenty - 12 (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. There would be an exception to this if:

- the amount was less than $10,000, or
- if she was in Canada for less than 183 days in any 12 month period beginning or ending in the current year and the employer was not a Canadian resident in a position to deduct the payments.

As neither of these exceptions apply, Michelle would be subject to Canadian taxes on the Canadian employment income.

Exam Exercise Solution Twenty - 13 (Non-Resident Employment In Canada)

Case 1 The employment income is taxable in Canada. The Canada/U.S. tax treaty allows Canada to tax employment income earned in Canada unless either of the following two exceptions is applicable:

- The first exception is the $10,000 rule. This exception however does not apply since Mary earned $13,300 Canadian in 2016 [($2,660)(5 months)].
- The second exception is the 183 day rule. Although Mary was in Canada for only 153 days during 2016 and therefore met the first part of the test, she failed the remaining part of the test since the employer was a Canadian resident and could deduct the payments.

Case 2 The employment income is not taxable in Canada. The 183 day rule exempts the income from Canadian taxation because the employer was not resident in Canada, nor had a permanent establishment in Canada, and could not deduct the payments.

Case 3 The employment income is taxable in Canada. The Canada/U.S. tax treaty would exempt the income from Canadian tax if the amount was less than $10,000 Canadian, or if Bill spent less than 183 days in Canada. As he earned $53,000 Canadian and spent 217 days at his job in Canada, neither of these exceptions are applicable.

Exam Exercise Solution Twenty - 14 (Non-Resident Employment In Canada)

Case 1 John would be taxable in Canada. In general, employment income of non-residents is taxable in Canada under ITA 2(3). The Canada/U.S. tax treaty provides two exceptions to this general rule as follows:

- The first exception is for individuals with employment income of less than $10,000. As John's salary is $72,000, this does not apply.
- The second exception is when the individual is in Canada for less than 183 days and the amounts are paid by an employer who is not a Canadian resident and cannot deduct the salary payments for Canadian tax purposes. While John is in Canada for less than 183 days, his employer is a Canadian business that can deduct the payments.

Case 2 The employment income is not taxable in Canada. While his earnings exceed $10,000, he is Canada for less than 183 days and his employment income is paid by a U.S. company that cannot deduct the payments for Canadian tax purposes. This means that, under the Canada/U.S. tax treaty, he is exempted from the general rule under ITA 2(3).

Case 3 In this case, the employment income would be taxable. As noted, the 183 day exception is only available when the employment income is not paid by an enterprise that can deduct the amounts paid for Canadian tax purposes. It would appear that the Montreal subsidiary will be able to deduct the payments for Canadian tax purposes.

Exam Exercise Solution Twenty - 15 (Dispositions Of Taxable Canadian Property)

Case 1 Anne is taxable on the gain. The condo is taxable Canadian property since it is real property (e.g. land and buildings) situated in Canada. The Canada/U.S. tax treaty gives Canada the right to tax such gains. The property is not exempt from Canadian tax as a principal residence since Anne did not acquire the condo for her own habitation.

Case 2 Anne would be taxable on the gain on the shares. Shares of an unlisted Canadian corporation are taxable Canadian property. In addition, the Canada/U.S. tax treaty allows Canada to tax gains on the disposition of shares if the value of the shares is derived principally from real property situated in Canada.

Case 3 Anne would not be taxable on the gain on the shares. The shares are taxable Canadian property because they represent shares of an unlisted non-resident corporation that, at some time in the 60 months preceding the disposition, derived more than 50 percent of their value from taxable Canadian property. However, the Canada/U.S. tax treaty does not list this as one of the items where Canada is allowed to tax U.S. residents.

Exam Exercise Solution Twenty - 16 (Interest Payments To Non-Residents)

The Canada/U.S. tax treaty states the following:

> **Article XI** Interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State may be taxed only in that other State.

This means that, with respect to interest paid to U.S. residents, Canada does not have the right to withhold taxes under Part XIII. As a result, there would be no Part XIII tax withheld in any of the three Cases.

Exam Exercise Solution Twenty - 17 (Rental Payments To Non-Residents)

Case 1 Carco appears to be carrying on business in Canada through a permanent establishment. As a result, no Part XIII tax is payable. However, Carco would be subject to Part I tax on its income attributable to the permanent establishment in New Brunswick.

Case 2 As the Canada/U.S. tax treaty does not reduce the rate for rentals of real property, Danielle would be subject to Part XIII tax of $11,500 [(25%)($46,000)]. Alternatively, Danielle could elect under ITA 216 to be taxed under Part I on the net rental income of $28,500 ($46,000 - $17,500). Based on her net rental income, the Part XIII tax is at a rate of 40.4 percent ($11,500 ÷ $28,500). Unless she has a significant amount of other income in Canada, the Part I alternative will result in her being taxed at the lowest federal rate, making this the preferable choice.

Case 3 Danielle would be subject to Part XIII tax on the gross rents received for the all terrain vehicles unless she would be considered to be carrying on a business. However, the Canada/U.S. tax treaty reduces the withholding tax to 10 percent of the gross rents received, or $400. Note that Danielle would not be eligible to elect under ITA 216 to be taxed under Part I on the all terrain vehicle rents, since this election is generally restricted to real property.

Exam Exercise Solution Twenty - 18 (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 Twenty - 19 (Emigration)

As real property is exempt from the deemed disposition provision contained in ITA 128.1(4)(b), there would be no tax consequences with respect to the rental property at the time of Mrs. Rand's departure. However, real property is Taxable Canadian Property and, as a consequence, she would be liable for Canadian taxes on both recapture and capital gains resulting from a subsequent sale of the property, even after she becomes a non-resident.

Exam Exercise Solution Twenty - 20 (Emigration)

Maximum Net Income With respect to the shares of the Canadian private company, there would be a required deemed disposition, resulting in a taxable capital gain of $62,500 [(1/2)($240,000 - $115,000)]. As the rental property is Taxable Canadian Property, there would be no deemed disposition on it at the time of Mr. Koch's departure.

Minimum Net Income While there would be no automatic deemed disposition on the rental property, Mr. Koch could elect under ITA 128.1(4) to have a deemed disposition. The result would be a terminal loss on the building of $43,000 [$121,000 - ($105,000 - $27,000)] and an allowable capital loss on the land of $14,000 [(1/2)($55,000 - $27,000)]. These amounts can be used to eliminate all but $5,500 ($62,500 - $43,000 - $14,000) of the taxable capital gain on the securities.

Exam Exercise Solution Twenty - 21 (Short Term Residents)

In the absence of ITA 128.1(4)(b)(iv)], there would be a deemed disposition of both the Israeli shares and the Canadian shares at the time of Dakota's departure from Canada. However, as it appears that she has been in Canada for less than 60 months in the last 10 years, there will be no deemed disposition of the Israeli shares that she owned prior to her immigration to Canada. There will however, be a deemed disposition of the Canadian shares acquired during her stay. This will result in a taxable capital gain of $7,500 [(1/2)($70,000 - $55,000)]

There will be no deemed disposition of the Canadian land because real property is exempt from the deemed disposition requirement of ITA 128.1(4)(b). Note, however, that vacant land is Taxable Canadian Property. This means that any gain resulting from its disposition will be subject to Canadian taxes, without regard to whether the vendor is a Canadian resident.

Exam Exercise Solution Twenty - 22 (Foreign Tax Credits)

Since there is no permanent establishment in the U.S., the income will be taxed in Canada. Shelley's tax liability would be calculated as follows:

Foreign Business Income Received ($23,000 - $2,300)	$20,700
Foreign Tax Withheld	2,300
Taxable Income Inclusion	$23,000
Canadian Tax Payable [(42%)($23,000)]	$ 9,660
Foreign Tax Credit (Given)	(2,300)
Net Canadian Tax Payable	$ 7,360
Foreign Tax Withheld	2,300
Total Taxes Payable	$ 9,660

Based on these figures, her after tax retention and overall tax rate would be as follows:

After Tax Retention ($23,000 - $9,660)	$13,340
Overall Tax Rate ($9,660 ÷ $23,000)	42%

Exam Exercise Solution Twenty - 23 (FAPI)

Subco is a controlled foreign affiliate of Parco. Given this, Parco is required to accrue its proportionate share (100%) of Subco's investment income. The required calculation for 2016 is as follows:

FAPI [ITA 91(1)]	$250,000
Deduct Lesser Of:	
• FAPI = $250,000	
• ITA 91(4) Deduction [(4)(15%)($250,000)]	(150,000)
Net Addition To Net Income For Tax Purposes	$100,000

Exam Exercise Solution Twenty - 24
(Dividends From FAPI - Twenty-23 Continued)

The required calculation for 2017 is as follows:

Foreign Source Dividend – ITA 90(1)	$212,500
Deduct Lesser Of:	
• Previous FAPI After ITA 91(4) Deduction = $100,000	
• Dividend Received = $212,500	(100,000)
Net Addition To Net Income For Tax Purposes	$112,500

TIF Solution Twenty - 5A

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

A. 4

B. 7

C. 6

D. 3

E. 2

F. 1

G. 10

H. 9

The two unused definitions are as follows:

International Tax Treaty = 5

Non-Resident = 8

TIF Solution Twenty - 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 8)

B. 9

C. 6

D. 3

E. 2 (not 7)

F. 1

G. 12 (not 14)

H. 11 (not 13)

The two unused definitions are as follows:

International Tax Treaty = 5

Non-Resident = 10

TIF Solution Twenty - 6

Mr. Morris would fall under the part year resident rules and would only be assessed for Canadian taxes on worldwide income during the portion of the year prior to his ceasing to be a resident of Canada.

By selling his house, disposing of other personal property, and resigning from various social and professional clubs, Mr. Morris appears to have done most of the things that would be required to establish that he had made a clean break from Canada as of April 1. However, S5-F1-C1 indicates that, in general, the CRA will view an individual as becoming a non-resident on the latest of three dates:

- The date the individual leaves Canada.
- The date the individual's spouse or common-law partner and dependants leave Canada.
- The date the individual becomes a resident of another country.

Because of the continued presence in Canada of the spouse and dependent children of Mr. Morris, he would be considered a resident of Canada until June 30, the latest of the relevant dates.

In terms of tax consequences, he would be subject to Canadian taxes on his salary until March 31. He would then be subject to U.S. taxes on income earned in that country after March 31. However, he would also be liable for Canadian taxes during the period April 1 through June 30. While he would be eligible for a tax credit for U.S. taxes paid on this income, the fact that Canadian taxes are generally higher than those in the U.S. would probably result in a liability for Canadian taxes during this period until his family departs from Canada.

TIF Solution Twenty - 7

Case A

As Mr. Plesser became a Canadian resident on July 1 of the current year, he would be subject to Canadian Part I tax on his worldwide income for the part of a year subsequent to that date. This would include all of his employment income, as well as one-half (£5,500) of his U.K. interest.

Case B

Members of the Canadian armed forces are deemed to be Canadian residents without regard to where they actually live. As Mrs. Jurgens is exempt from German taxation due to her relationship to a deemed resident, she is a deemed resident and will be subject to Canadian taxation on her employment income.

Case C

While Mr. Downs is not a Canadian resident, ITA 2(3) generally applies Part I tax to employment income earned in Canada. However, the Canada/U.S. tax treaty makes two exceptions to this general approach:

> **$10,000 Rule** Under this rule if, during a calendar year, a U.S. resident earns employment income in Canada that is $10,000 or less in Canadian dollars, then the income is taxable only in the U.S.
>
> **183 Day Rule** This rule exempts Canadian source employment income from Canadian taxation, provided it is earned by a U.S. resident who was physically present in Canada for no more than 183 days in any twelve month period commencing or ending in the calendar year. This exemption is conditional on employment income not being paid by an employer who would be able to deduct the amount paid from their Canadian Taxable Income.

While Mr. Downs is in Canada for less than 183 days, it would appear that his employer is in a position to deduct the payments from Taxable Income. As the amount is more than $10,000, neither exception is applicable and Mr. Downs would be taxed on his Canadian employment income.

With respect to the interest, it is an arm's length payment and does not involve participating debt. As a consequence, Part XIII tax is not applicable. In addition, it should be noted that the Canada/U.S. tax treaty has a provision which does not allow either country to assess taxes on interest paid to residents of the other country.

Case D

While Ms. Mennan has a small Canadian savings account, it is unlikely that the CRA would consider this a sufficient tie with Canada to view her as a resident. She would be considered a non-resident.

With respect to the interest she received, Part XIII would not be applicable because it is an arm's length payment and does not involve participating debt. In addition, as was noted in Case C, the Canada/U.S. tax treaty has a provision which does not allow either country to assess taxes on interest paid to residents of the other country.

TIF Solution Twenty - 8

Canada/U.S. Tax Treaty Tie Breaker Rule

In cases of dual residency for corporations, where a corporation could be considered a resident of both countries, the Canada/U.S. tax treaty indicates that the corporation will be deemed to be a resident only in the country in which it is incorporated.

Case A

While Bonix is no longer operating in Canada, it was incorporated here and it is deemed a Canadian resident. However, as the mind and management of the Company are currently in the United States, the Company is also a resident of the U.S. Using the tie breaker rule, Bonix will be considered a resident of Canada.

Case B

Dorad Inc. was not incorporated in Canada and its mind and management are not currently located here. Therefore, Dorad would not be considered a resident of Canada.

Case C

The mind and management of Upton Inc. are in Canada and this suggests that the Company is a resident of Canada. However, as Upton Inc. was incorporated in the U.S., it is also a resident of the U.S. Using the tie breaker rule, the Upton Inc. will be considered a resident of the U.S. and a non-resident of Canada.

Case D

Carlin Inc. was incorporated in Canada which means Carlin is a deemed resident of Canada. However, because the mind and management of the Company are in the United States, it is also a resident of the U.S. Using the tie breaker rule, Carlin Inc. will be considered a resident of Canada.

TIF Solution Twenty - 9

Case A

Mr. Salazar is not a resident of Canada. Commuting across the border for employment purposes is not considered sojourning (S5-F1-C1). However, unless he is exempted by the Canada/U.S. tax treaty, he would be subject to Canadian taxation on the employment income which he earns in Windsor.

With respect to the treaty exemption, his employment income exceeds $10,000 and he is physically present in Canada for more than 183 days in the year. Given these facts, he would not qualify for the treaty exemption.

Case B

The information suggests that Mr. Wills made a clean break with Canada on September 1 of the current year. As a consequence, he would be considered a Canadian resident for the portion of the current year prior to his departure and would be taxed on his worldwide income for this period. For the portion of the year subsequent to his departure, he would no longer be considered a Canadian resident.

Case C

Joan Brothers would be deemed to be a Canadian resident under ITA 250(1)(f) because she is a dependent child of an officer or servant of Canada who is deemed to be a resident of Canada under ITA 250(1)(c)(i).

Case D

Brogan Inc. was not incorporated in Canada and its mind and management are not currently within Canada. As a result, the Company is not a Canadian resident and none of its income would be subject to Canadian taxes.

Case E

Mercer Ltd. was incorporated prior to April 27, 1965 and, if it had not resided in or done business in Canada subsequent to that date, it would not be considered a resident of Canada. However, the fact that directors meetings were held in Canada until May, 1993 makes it a Canadian resident. As the mind and management are now in the U.S., it would also be considered a resident of that country.

In cases of dual residency for corporations, where a corporation could be considered a resident of both countries, the Canada/U.S. tax treaty indicates that the corporation will be deemed to be a resident only in the country in which it is incorporated. Mercer Ltd. would be a resident of Canada and its worldwide income would be subject to tax in Canada.

Case F

The Booker Manufacturing Company would be considered resident in Canada because of the location of its mind and management. However, as Booker was incorporated in the U.S., it would also be considered a resident of that country. In cases of dual residency for corporations, where a corporation could be considered a resident of both countries, the Canada/U.S. tax treaty indicates that the corporation will be deemed to be a resident only in the country in which it is incorporated. As a result, the Company is not a Canadian resident and none of its income would be subject to Canadian taxes.

TIF Solution Twenty - 10

Part A

As she is exempt from taxation in Indonesia because she is related to a deemed resident, Dorothy would be a deemed resident of Canada for income tax purposes during the current year under ITA 250(1)(g).

Part B

As she is present in Canada on a temporary basis for more than 183 days per year, she would be considered a sojourner. Under ITA 250(1)(a), this would make her a Canadian resident for income tax purposes for all of the current year.

Part C

Because he has an employment contract that requires him to return to Canada, he will be a Canadian resident for income tax purposes during the current year. Although he has severed his ties with Canada, the requirement to return would show that he does not intend to permanently leave Canada.

Part D

Millicent would be a Canadian resident for income tax purposes during the current year. An individual is not considered to have departed from Canada until the latest of the departure date, the date of departure for their spouse and children, and the date on which residence is established in a different country. As her family is staying in Canada and Millicent will not be establishing residency in another country, she will remain a Canadian resident during her trip.

Part E

ITA 250(4)(c) indicates that a corporation is resident in Canada if it was incorporated in Canada prior to April 27, 1965 and carried on business, or was resident in Canada, in any year ending after April 26, 1965. However, as the mind and the management of the company is in the U.S., it is also a resident of that country. In cases of dual residency for corporations, where a corporation could be considered a resident of both countries, the Canada/U.S. tax treaty indicates that the corporation will be deemed to be a resident only in the country in which it is incorporated. Given this, Berkley Management would be a resident of Canada.

Part F

The company was not incorporated in Canada and the mind and management of the company is not in Canada. Lorris Ltd. is not a resident of Canada.

TIF Solution Twenty - 11

Case A

As Sharon is earning employment income in Canada, she would generally be taxable under ITA 2(3). With respect to the Canada/U.S. tax treaty provisions, while her income exceeds $10,000, her stay in Canada is less than 183 days. However, her employment income would be deductible by the payor Canadian corporation. This means that Sharon would be subject to Part I tax on her Canadian employment income.

Case B

As Mariah is earning employment income in Canada, she would generally be taxable under ITA 2(3). With respect to the Canada/U.S. tax treaty provisions, while her income exceeds $10,000, her stay in Canada is less than 183 days. In addition, the payor is not a Canadian entity that will be able to deduct these payments against Canadian taxes. Given this, Mariah would be exempt from Part I tax under the provisions of the Canada/U.S. tax treaty.

Case C

With respect to private companies incorporated in Canada if, within the preceding 60 month, more than 50 percent of their value is derived from Canadian real property, their shares are considered to be Taxable Canadian Property. This means that gains on the sale of such shares would be taxable under ITA 2(3). While the Canada/U.S. tax treaty serves to exempt gains on certain types of Taxable Canadian Property (generally, shares that during the last five years did not derive their value largely from Canadian real property), shares of Canadian incorporated private companies is not on this list. Therefore, Part I tax would be applicable on the gain.

Case D

Shares of unlisted companies are viewed as Taxable Canadian Property if, within the preceding 60 months, more than 50 percent of their value is derived from Canadian real property. This means that Rae's shares would be considered Taxable Canadian Property and the gain would be considered taxable under ITA 2(3). However, Rae's corporation is not a "Canadian" corporation and this means that it is not on the Canada/U.S. tax treaty list of Taxable Canadian Property where gains accruing to U.S. residents are subject to Canadian tax. Therefore, Part I tax would not be applicable on the gain.

Case E

Under the Canada/U.S. tax treaty, Part I tax is applicable to a U.S. resident only when the business is carried on through a permanent establishment. While the U.S. firm in this Case is carrying on business, it is not through a permanent establishment. The treaty specifically exempts the warehouse as it is used exclusively for holding inventories. In addition, Martha Faulk could not be viewed as a permanent establishment as she does not have authority to conclude individual sales contracts. Part I tax would not be applicable in this case.

Case F

This Case differs from Case E in that the warehouse is used for more than holding inventories. This means that it is not an excluded facility under the Canada/U.S. treaty. Further, as Martha Faulk has the authority to conclude contracts, she, as a person, would be viewed as a permanent establishment. This means that Orex would be considered to be carrying on business in Canada through a permanent establishment. Therefore, Part I tax would be applicable.

TIF Solution Twenty - 12

Case 1

While the interest is being paid on participating debt, Bryan is a resident of the U.S. The Canada/U.S. tax treaty exempts U.S. residents from Part XIII tax on all interest payments. Clark would not be subject to Part XIII tax and no Canadian tax would be payable.

Case 2

Part XIII tax is applicable to interest only if the interest is paid on participating debt or is paid to a non-arm's length non-resident. The debt is not participating and Michael is at arms' length with the Canadian bank. Given this, Part XIII tax would not be applicable and no Canadian tax would be payable.

Case 3

While the Canada/U.S. tax treaty reduces the Part XIII rate on dividends, Brigitte is a resident of a country that does not have a tax treaty with Canada. Given this, the $4,800 in dividends would be taxed at the full 25 percent Part XIII rate and the tax would equal $1,200 [(25%)($4,800)].

Case 4

As Richard is a resident of the U.S., the Canada/U.S. tax treaty would be applicable. Under this treaty, the Part XIII rate on rents of assets other than real property is reduced to 10 percent. Given this, his Part XIII tax would be $54,600 [(10%($546,000)]. Note that the election to be taxed under Part I is only available when the asset being rented is real property. Therefore, the Part I election would not be available to Saul and the Part XIII tax must be paid.

Case 5

As Frank is not a resident of a country with which Canada has a tax treaty, he would be subject to Part XIII tax at a rate of 25 percent. This would require a payment of $5,750 [(25%)($23,000)]. Alternatively, he could elect to be taxed under Part I on his net income of $10,000 ($23,000 - $13,000). As the Part XIII tax as a percent of his net rental income is 57.5 ($5,750 ÷ $10,000), a rate well above any Canadian rate on individuals, the Part I election would clearly be a better alternative.

Case 6

Kristopher is a resident of a country that does not have a tax treaty with Canada. In addition, the interest is paid on participating debt. Given these facts, the interest would be subject to Part XIII tax at the 25 percent rate and the tax would equal $86.75 [(25%)($347)].

TIF Solution Twenty - 13

Part A

As Ms. Houston appears to have severed all residential ties with Canada and she and her employer do not anticipate that she will return in the foreseeable future, it does not appear that she will be considered a Canadian resident after her move to Australia.

An individual is considered to have ceased being a resident of Canada as of the latest of:

- the date they leave Canada,
- the date their spouse, common-law partner and/or other dependants leave Canada, and
- the date they become a resident of the country to which they are immigrating.

For Ms. Houston, the latest of these dates is September 1, 2016, the day that she established residence in Sydney. This means that she will be considered to be a resident of Canada for the period January 1 through August 31, 2016.

Part B

Based on this analysis, the Net Income For Tax Purposes that would be shown in her 2016 Canadian tax return would be as follows:

Income Under ITA 3(a):		
Employment Income While Canadian Resident [($12,000)(8 Months)]	$96,000	
Canadian Interest Income	3,500	
Australian Interest Income While Canadian Resident [($500)(1 Month)]	500	$100,000
Income Under ITA 3(b):		
Taxable Capital Gains [(1/2)($27,300)]	$13,650	
Allowable Capital Losses [(1/2)($14,500 + $6,800)]	(10,650)	3,000
Balance From ITA 3(a) And (b)		$103,000
Subdivision e Deductions [($2,000)(8) + $8,800]		(24,800)
Balance From ITA 3(c)		$ 78,200
Deduction Under ITA 3(d):		
Business Loss		(27,000)
Net Income For Tax Purposes		$ 51,200

There would be no loss carry overs arising from the 2016 information.

TIF Solution Twenty - 14

For each of the listed assets, the tax consequences that result from Mr. Rankin's departure are as follows:

City Home* The city home would be classified as Taxable Canadian Property and, as a consequence, there would be no deemed disposition at the time of Mr. Rankin's departure. However, if there is a later disposition after Mr. Rankin is no longer a Canadian resident, any gain on the property would be subject to Canadian taxation.

Cottage* As was the case with the city home, the cottage would be classified as Taxable Canadian Property. There would be no deemed disposition when Mr. Rankin leaves Canada. However, if there is a later disposition after Mr. Rankin is no longer a Canadian resident, any gain on the property would be subject to Canadian taxation.

*While this is not a required part of the solution, we would note that either the city home or the cottage could qualify for the principal residence exemption. However, this would require an election for a deemed disposition of the relevant property.

Automobile While gains or personal use property are taxable, losses are not deductible. Given this, there would be no tax consequences associated with the deemed disposition of the automobile.

Cash There are never any tax consequences associated with dispositions of cash.

RRSP As an "excluded right", there will be no deemed disposition of the RRSP assets when Mr. Rankin departs from Canada. Assuming he does not collapse his RRSP prior to departure, these amounts will be taxed under Part XIII when they are withdrawn and remitted to Mr. Rankin.

Shares In A CCPC There is no exemption from the deemed disposition rules for shares in a CCPC unless more than 50 percent of the fair market value of the share or interest was derived from certain properties including Canadian real property, Canadian resource properties and timber resource properties.

Since the CCPC provides cleaning services, there would be a deemed disposition of these shares, resulting in a taxable capital gain of $7,500 [(1/2)($80,000 - $65,000)].

Shares In Public Companies There is no exemption from the deemed disposition rules for shares of public companies unless more than 50 percent of the fair market value of the share or interest was derived from certain properties including Canadian real property, Canadian resource properties and timber resource properties.

Since the public companies are banks, there would be a deemed disposition of these shares, resulting in a taxable capital gain of $39,000 [(1/2)($120,000 - $42,000)].

TIF Solution Twenty - 15

1. Foreign investment reporting is not required. Since the cottage is personal use property, the fact that the cost is greater than $100,000 is not relevant. The fair market value is also not relevant.

2. Foreign investment reporting is required as the balance was greater than $100,000 at some point in the year.

3. Foreign investment reporting is not required as the cost of the shares is less than $100,000. The fact that their current fair market value exceeds $100,000 is not relevant.

4. No foreign investment reporting is required as the assets are used in an active business.

TIF Solution Twenty - 16

As a Canadian resident, Ms. Borody would be taxed on her worldwide income. This would include all of the German investment income. The amounts to be included in her Net Income For Tax Purposes would be as follows:

Dividends Since 15 percent was withheld from the dividends, the gross dividend income totals €6,000 (€5,100 ÷ 85%). Converted to Canadian dollars, the amount to be included in Ms. Borody's Net Income For Tax Purposes would be $8,700 [($1.45)(€6,000)]. The German dividends will not be grossed up as would be eligible dividends received from public Canadian corporations. They would also not give rise to a dividend tax credit. The foreign taxes withheld would generate a credit against Tax Payable of $1,305 [($1.45)(€6,000 - €5,100)].

Interest The interest income would be converted to Canadian dollars and the amount included in Ms. Borody's Net Income For Tax Purposes would be $2,900 [($1.45)(€2,000)]. The fact that it has not been removed from the German bank account is irrelevant as she is taxed on her worldwide income.

Rental Income As Ms. Borody uses the Part I election to report rental income, the amount to be included in her Net Income For Tax Purposes would be based on €18,000. Converted to Canadian dollars, this amount would be $26,100 [($1.45)(€18,000)]. As no German taxes were withheld, no tax credit is available on this amount.

TIF Solution Twenty - 17

The SP Ltd. withholding equals 25 percent ($4,250 ÷ $17,000) of the dividend paid. The FR Ltd. tax withholding equals 10 percent ($800 ÷ $8,000) of the dividend paid.

As the foreign non-business tax credit is limited to 15 percent, the additional 10 percent ($1,700) withheld by Foreign Country 1 will have to be deducted in the determination of Mark's Net Income For Tax Purposes.

Net Employment Income	$ 67,500
Taxable Capital Gains	4,500
Eligible Canadian Dividends	12,000
Gross Up [(38%)($12,000)]	4,560
SP Ltd. Dividends (No Gross Up)	17,000
FR Ltd. Dividends (No Gross Up)	8,000
Excess Withholding [(25% - 15%)($17,000)]	(1,700)
Net Income For Tax Purposes	$111,860
Net Capital Loss Carry Forward*	(4,500)
Business Loss Carry Forward	(6,200)
Taxable Income	$101,160

* The net capital loss carry forward is limited to the taxable capital gains.

Using this result, Mark's Taxable Income would be calculated as follows:

Tax On First $90,563		$16,075
Tax On Next $10,597 ($101,160 - $90,563 At 26%)		2,755
Tax Payable Before Credits		$18,830
Basic Personal Credit	($11,474)	
EI	(955)	
CPP	(2,544)	
Canada Employment	(1,161)	
Total Credit Amount	($16,134)	
Applicable Rate	15%	(2,420)
Tax Otherwise Payable		$16,410
Dividend Tax Credit [(6/11)($4,560)]		(2,487)
Foreign Tax Credits (See Note)		
SP Ltd.		(2,550)
FR Ltd.		(800)
Federal Tax Payable		$10,573

Note The foreign non-business tax credits are calculated on a country by country basis (see Chapter 11).

For use in the following formula, Adjusted Division B Income would be equal to $107,360 ($111,860 - $4,500). Note that the business loss carry forward is not deducted in this calculation. As shown in the preceding table, Tax Otherwise Payable would be before the deduction of the dividend tax credit.

The tax credit on the SP Ltd. shares would be the lesser of:

- Amount Withheld (Limited To 15%) = [(15%)($17,000)] = $2,550
- [(Foreign Non-Business Income
  ÷ Adjusted Division B Income)(Tax Otherwise Payable)]

  = ($17,000 ÷ $107,360)($16,410) = $2,598

The tax credit on the FR Ltd shares would be the lesser of:

- Amount Withheld (Less Than 15%) = $800
- [(Foreign Non-Business Income
  ÷ Adjusted Division B Income)(Tax Otherwise Payable)]

  = ($8,000 ÷ $107,360)($16,410) = $1,223

Chapter Twenty-One Test Item File Solutions

TIF Solution Twenty-One - 1

1. The main advantages can be described as follows:

   - An HST system is less complex. With an HST system, the staff of the business only has to understand and deal with one set of rules. In contrast, under a GST/PST system, two separate sets of rules must be dealt with.
   - An HST system has lower compliance costs. GST/PST systems require the filing of two separate tax returns, as opposed to the one return that is required with an HST system.
   - With an HST system, business organizations receive input tax credits for the taxes paid on their purchases. They receive input tax credits for only the GST portion under a GST/PST system.

2. The required two factors can be selected from the following:

   - **Simplicity** Transaction taxes are easy to administer and collect. No forms are required from individuals paying the tax and, if the individual wishes to acquire a particular good or service, it is difficult to evade payment.
   - **Incentives To Work** An often cited disadvantage of income taxes is that they can discourage individual initiative to work and invest. Transaction taxes do not have this characteristic.
   - **Consistency** Transaction taxes avoid the fluctuating income and family unit problems that are associated with progressive income tax systems.
   - **Keeping The Tax Revenues In Canada** While some types of income can be moved out of Canada, resulting in the related taxes being paid in a different jurisdiction, taxes on Canadian transactions remain in Canadian hands.

3. The problem is that there is pyramiding of taxes. When the tax is applied at each level using normal markups, there is a tax on taxes that have been previously paid. This can result in a very high overall rate being charged in the process of getting the product to the ultimate consumer.

4. An accounts-based value added tax system applies a specified rate to the value added at each stage in the production/distribution process. Such systems require an accounting based measurement of the amount of value added.

   An invoice-credit value added tax applies a specified rate to the revenue generated at each stage in the production/distribution process. The remittance of this amount is offset by claiming input tax credits for the tax that has been paid on all current purchases and on the full amount of capital expenditures used in producing these revenues. Its application involves no matching of costs and revenues, and no allocation of costs to periods other than the period in which the asset was acquired.

5. The GST/HST consequences are as follows:

   Fully Taxable Goods And Services The vendor would charge GST/HST on all such sales. The vendor would be eligible for input tax credits for GST/HST paid on the costs associated with such sales.

   Zero-Rated Goods And Services The vendor would not charge GST/HST on such sales. The vendor would be eligible for input tax credits for GST/HST paid on the costs associated with such sales.

   Exempt Goods And Services The vendor would not charge GST/HST on such sales. The vendor would not be eligible for input tax credits for GST/HST paid on the costs associated with such sales.

6. With respect to tangible goods, GST/HST will be collected using the rules of the province where the goods are delivered.

   With respect to services, GST/HST will be collected using the rules of the province where the recipient of the services is located.

7. HST will only be levied on the net cost of the new car. The 13 percent rate will be applied to the cost of the new car, less the trade-in allowance provided.

8. While several examples could be cited here, unincorporated businesses (proprietorships and partnerships) and not-for-profit organizations are most commonly mentioned in the text.

9. In general, non-residents are not required to register for GST/HST. However, if a non-resident is carrying on business in Canada, registration would be required. In addition, a non-resident could voluntarily register.

10. Under this test, an entity qualifies as a small supplier in the current quarter and the month following the current quarter if, during the calendar four quarters preceding the current quarter, the entity and its associated entities did not have cumulative taxable supplies exceeding $30,000.

11. The basic questions that should be asked are as follows:

    - Do you have large amounts of fully taxable costs that would generate input tax credits?
    - Do you expect to exceed $30,000 in annual taxable sales in the near future?
    - Would adding GST/HST to your sale price reduce your ability to compete?

12. For capital expenditures on real property, the GST/HST paid is eligible for an input tax credit at the time of purchase. However, if the property is not used exclusively for commercial activity, only a portion of the GST/HST is eligible for the credit. The portion is based on the extent to which the property is used for commercial activity. This is subject to a minimum rule (there is no input tax credit if the property is used 10 percent or less for commercial activity) and a maximum rule (100 percent of the GST/HST paid is eligible for the credit if the property is used 90 percent or more for commercial activity).

    For most capital expenditures other than real property (capital personal property), the GST/HST paid is eligible for an input tax credit at the time of purchase. However, if the property is used 50 percent or less for commercial activity, no credit is available. Alternatively, if the property is used more than 50 percent for commercial activity, 100 percent of the GST/HST paid is eligible for an input tax credit.

13. Input tax credits on current expenditures are available at the time the expenditure is made, without regard to matching with related revenues. If all, or substantially all (generally understood to mean 90 percent or more), of a current expenditure is related to commercial activity, then all of the GST/HST that was paid can be claimed as an input tax credit. In contrast, if 10 percent or less of an expenditure is related to commercial activity, no input tax credit can be claimed. If the percentage of the current expenditure used for commercial activity is between 10 and 90 percent, the input tax credit available is calculated by multiplying the total GST/HST paid by the percentage of commercial activity usage.

14. The required two examples can be selected from the following:

    Passenger Vehicles No input tax credits are available for GST/HST paid on the portion of the cost or lease payment of a passenger vehicle that is in excess of the prescribed limits (see Chapter 6 for details on these limits).

    Club Memberships No input tax credit is allowed for GST/HST paid on membership fees or dues in any club whose main purpose is to provide dining, recreational, or sporting facilities.

    Provision Of Recreational Facilities No input tax credits are available for the GST/HST costs of providing certain types of recreational facilities to employees, owners, or related parties.

    Business Meals And Entertainment The recovery of GST/HST on meals and entertainment expenses is limited to 50 percent of the amounts paid.

    Personal Or Living Expenses Input tax credits cannot be claimed on costs associated with the personal or living expenses of any employee, owner, or related individual.

    Reasonableness Both the nature and value of a purchase must be reasonable in relation to the commercial activities of the registrant before an input tax credit can be claimed.

15. With respect to the GST that is received with revenues, these amounts will have to be remitted to the government and should not be included in reported revenues.

    With respect to the GST included in expenses, its treatment in the financial statements of an enterprise will depend on whether or not it will be refunded as an input tax credit. If it is eligible for input tax credit treatment, it should be excluded from the expenses reported. Alternatively, if the amounts will not be refunded, they should be included in the expenses reported.

    With respect to GST assets (refunds) or liabilities (payments), they should be reported in full in the Balance Sheet of the enterprise.

16. The major advantages of using the Quick Method can be described as follows:

    - As the remittance rate is charged on GST/HST inclusive sales, there is no need for separate tracking of GST/HST collections.
    - There is no requirement to separately track purchases, other than those for capital expenditures, in order to determine the amount of input tax credits.
    - While this is not always the case, the Quick Method may reduce the amount of GST/HST that would be paid by the registrant if he were to use the regular accounting method for determining his GST/HST liability. Note, however, the use of this method may also increase the amount to be paid.

17. Under the streamlined method of accounting for input tax credits, detailed records are not kept of the GST/HST that is paid on all purchases other than real property. The total GST/HST and non-refundable PST inclusive amount of fully taxable costs incurred, including eligible costs incurred for capital assets other than real property, is multiplied by a factor to arrive at the figure that will be used for input tax credits in the GST/HST return of the registrant.

    The factor used will depend on the GST/HST rate in the province (e.g., 5/105 in Alberta, 13/113 in New Brunswick). As with the regular method of calculation, separate attention is given to the GST/HST paid on real property. This means that this amount will have to be pro rated based on the extent to which it is used in commercial activity.

18. This would happen if the entity had input tax credits in excess of GST/HST collections on a regular, ongoing basis. This type of situation would entitle the entity to regular payments from the government. An example of this would be a business selling goods for export.

19. The required two could be selected from the following:

    - Determining whether they qualify for the small supplier's exemption,
    - Determining whether they are eligible for the Quick Method of accounting,
    - Determining whether they are eligible for the streamlined method of calculating input tax credits,
    - Determining the required filing frequency of their returns (i.e., monthly, quarterly or annually).

20. Employees and individual partners are not GST/HST registrants and, in the absence of a special provision, would not be eligible to claim input tax credits for their employment or business related expenditures. The Employee and Partner GST/HST Rebate allows employees and partners to recover the GST/HST paid on their employment or partnership related expenditures in a way that is similar to the input tax credits that they would have received if they were GST/HST registrants.

21. For homes that cost $350,000 or less, the rebate is equal to 36 percent of the GST that is paid on the purchase. This provides a maximum rebate of $6,300 [(36%)(5%)($350,000)]. For homes that cost more than $450,000, no rebate is available. For homes costing between $350,000 and $450,000, the total rebate is reduced using the following formula:

    [A][($450,000 - B) ÷ $100,000]

    Where:
    A = The lesser of 36 percent of the GST paid and $6,300; and
    B = The greater of $350,000 and the cost of the home.

22. The major condition is that 90 percent or more of the assets needed to carry on the business must be transferred. In addition, the election is only available if both the purchaser and vendor are GST/HST registrants, if both the purchaser and vendor are non-registrants, or if the purchaser is a registrant and the vendor is a non-registrant. It cannot be used if the vendor is a registrant and the purchaser is a non-registrant.

TIF Solution Twenty-One - 2

1. True.

2. True.

3. False. Zero-rated supplies are taxed at a zero rate, thereby allowing the supplier to claim input tax credits.

4. False. GST is charged on the net amount of the purchase price, less the trade-in value.

5. True.

6. False. Input tax credits on real property are based on a pro rata amount determined by the percentage of usage for the production of taxable supplies.

7. True.

8. True.

9. False. The GST rebate is equal to 5/105 of the deductible expenses.

10. True.

11. True.

12. False. A multi-stage tax allows for a quicker accrual of revenues.

13. False. While they do not charge GST/HST on sales, they are still eligible to claim input tax credits.

14. True.

TIF Solution Twenty-One - 3

New For 2016/2017

1. C. The tax charged for spending a day in Banff National Park.

2. C. The sale of an life insurance policy by an insurance agency which is an exempt supply.

3. B. $2,300 [(5%)($82,000 - $36,000)

4. A. $322.12 [(13%)($2,800 ÷ 1.13)]

5. D [13%][$150,000 - ($96,000 + $83,000 + $17,000)] = ($5,980)

6. C. A business involved in legal, accounting and financial consulting services, cannot use the quick method.

7. A. Nil. [$6,300][($450,000 - $625,000) ÷ $100,000]

Retained From Previous Editions

8. A. All persons engaged in a business must register with the CRA for GST purposes.

9. C. Income taxes are less regressive than transaction taxes.

10. D. By providing a refundable GST tax credit that is available to low income individuals.

11. B. The purchase of milk at the grocery store.

12. A. Fully taxable supplies are taxed at the HST rate and zero-rated supplies are taxed at 0.0 percent. Expenditures related to both types of supplies are eligible for input tax credits.

13. C. Zero-rated supplies are taxable at 0.0 percent, while exempt supplies are not taxable. Expenditures related to zero-rated supplies are eligible for input tax credits and those related to exempt supplies are not.

14. D. An Ontario registrant ships a product to a recipient in Alberta.

15. C. August 1, 2016.

16. B. August 1.

17. D. All capital expenditures made during the period and goods purchased for resale during the period.

18. C. [($7,000 + $400 + $500)(5%)] = $395. An input tax credit is not permitted for the club fee as the fee is not deductible for income tax purposes.

19. C. $3,445.

Revenues	$30,000
Office supplies	(500)
Rent	(3,000)
Total	$26,500
Rate	13%
HST Payable	$ 3,445

20. C. $16,705.

Revenues	$300,000
Purchase of bicycles	(150,000)
Purchase of tires and other parts	(18,500)
Premises rental	(3,000)
Total	$128,500
Rate	13%
HST Payable	$ 16,705

21. B. $39,325.

Revenues	$325,000
Stationery and supplies	(5,000)
Utilities	(2,500)
Rent	(15,000)
Total	$302,500
Rate	13%
HST Payable	$ 39,325

22. B. Capital expenditures are not tracked separately for purposes of determining input tax credits. Real property purchases are tracked separately.

23. C. $8,810 [(5/105)($180,000 + $5,000)]

24. A. A Ltd. sells 100% fully taxable supplies, and B Ltd. sells 100% zero rated supplies. They would like to claim the full input tax credit on the purchase of a building for A Ltd.

25. E. All eligible expenses for fully taxable supplies deducted in the calculation of net employment income, including capital cost allowances.

26. B. $ 1,273 [(13/113)($1,100 + $4,176 + $5,791)]

27. D. The vendor is selling substantially all of the assets of his business. Neither the vendor nor the purchaser are GST/HST registrants.

28. B. The charity will not have to collect any GST on their clothing sales. (There is a $50,000 small supplier exemption for charities.)

29. B. The partnership is required to collect the GST/HST on taxable supplies and is eligible for input tax credits.

30. A. A distribution of taxable supplies by the trust to the beneficiaries.

TIF Solution Twenty-One - 4

Exam Exercise Solution Twenty-One - 1 (Alternative VAT Approaches)

The amount of tax to be paid under the two systems would be calculated as follows:

	Accounts Based System	Invoice Credit System
Value Added ($476,000 - $302,000)]	$174,000	N/A
Taxable Revenues	N/A	$476,000
Base For Credits	N/A	(371,000)
Subtotal	$174,000	$105,000
Rate	5%	5%
Total	$ 8,700	$ 5,250

The fact that the tax is less under the invoice-credit system reflects the fact that the purchases of goods exceeded the cost of goods sold.

Exam Exercise Solution Twenty-One - 2 (Alternative VAT Approaches)

The amount of tax to be paid under the two systems would be calculated as follows:

	Accounts Based System	Invoice Credit System
Value Added ($825,000 - $562,000)]	$263,000	N/A
Taxable Revenues	N/A	$825,000
Base For Credits ($562,000 + $150,000)	N/A	(712,000)
Subtotal	$263,000	$113,000
Rate	8%	8%
Total	$ 21,040	$ 9,040

The fact that the tax is less under the invoice-credit system reflects the fact that the purchases of goods exceeded the cost of goods sold.

Exam Exercise Solution Twenty-One - 3 (Requirement To Register)

As his sales exceed $30,000 in the third quarter, he will be required to begin collecting GST on the first sale in that quarter that exceeds the $30,000 threshold. This means he will have to begin collecting GST sometime between July 1 and September 30. He will be required to register within 29 days of that date.

Exam Exercise Solution Twenty-One - 4 (Requirement To Register)

Ms. Hammer's sales exceed $30,000 in the second quarter. This means that she will be required to begin collecting GST on the first sale in that quarter that exceeds the $30,000 threshold. This will be sometime between April 1 and June 30. Registration will be required within 29 days of that date.

Exam Exercise Solution Twenty-One - 5 (Requirement To Register)

As Ms. Holt's sales accumulate to more than $30,000 by the end of the third quarter, she will have to begin collecting GST on November 1, one month after the end of the quarter. (The fourth quarter sales are not relevant.) She will be required to register by December 26, within 29 days of the November 27 sale.

Exam Exercise Solution Twenty-One - 6 (Requirement To Register)

Mr. Gardens' sales accumulate to $32,000 ($18,000 + $14,000) by the end of the April/June quarter. This means that he will begin collecting GST on August 1, one month after the end of the quarter. He will be required to register by October 26, within 29 days of the September 27 sale.

Exam Exercise Solution Twenty-One - 7 (ITCs - Capital Expenditures)

As the building is real property, an input tax credit would be available on a pro rata basis. This means that the credit would be $25,375 [($1,450,000)(5%)(35%)]. No input tax credit would be available on the equipment as it is used less than 50 percent in the provision of taxable supplies.

Exam Exercise Solution Twenty-One - 8 ((ITCs - Capital Expenditures))

The available input tax credits would be calculated as follows:

Building [(13%)(100%)($2,825,000 ÷ 1.13)]	$325,000
Equipment [(13%)(100%)($904,000 ÷ 1.13)]	104,000
Total Available Input Tax Credits	$429,000

While there is a pro rata calculation on real property, the building is used 100 percent for taxable (fully and zero-rated) supplies. With respect to the equipment, it is used 60 percent (35% + 25%) for taxable supplies. This allows Logan to claim the input tax credit on 100 percent of the cost of the asset.

Exam Exercise Solution Twenty-One - 9 (GST Calculation)

The GST payable would be calculated as follows:

GST On Sales [(5%)($286,650 ÷ 1.05)]	$13,650
Input Tax Credits:	
Rent [(5%)($18,000)]	(900)
Salaries	Nil
Interest	Nil
Purchases Of Supplies [(5%)($4,500)]	(225)
Capital Expenditure [(5%)($32,000)]	(1,600)
GST Payable For The Year	$10,925

Exam Exercise Solution Twenty-One - 10 (GST Calculation)

The GST payable would be calculated as follows:

GST On Sales [(5%)($326,000)]	$16,300
Input Tax Credits:	
Rent [(5%)($36,000)]	(1,800)
Salaries	Nil
Interest	Nil
Purchases Of Supplies [(5%)($23,000 + $4,000)]	(1,350)
CCA	Nil
Capital Expenditure [(5%)($18,000)]	(900)
GST Payable For The Year	$12,250

Exam Exercise Solution Twenty-One - 11 (HST Calculation)

The HST payable would be calculated as follows:

HST On Sales [(13%)($136,000)]	$17,680
Input Tax Credits:	
Rent [(13%)($29,450)]	(3,829)
Assistant's Salary	Nil
Capital Expenditures [(13%)($43,700 + $18,000)]	(8,021)
HST Payable For The Year	$ 5,830

Exam Exercise Solution Twenty-One - 12 (HST Calculation)

As the vehicle is owned by an individual and used more than 90 percent for business purposes, the input tax credit is based on 100 percent of the cost for GST purposes. However, in calculating the input tax credit, the cost of the car is limited to the Class 10.1 maximum of $30,000.

HST On Sales [(15%)($517,500 ÷ 1.15)]	$67,500
Input Tax Credits:	
Rent [(15%)($48,000)]	(7,200)
Salaries To Employees	Nil
Interest On Business Loan	Nil
Office Supplies [(15%)($14,000 - $3,000)]	(1,650)
CCA	Nil
Vehicle [(15%)(100%)($30,000)]	(4,500)
HST Payable For The Year	$54,150

Exam Exercise Solution Twenty-One - 13 (Quick Method)

The HST refund under the regular method would be calculated as follows:

HST On Sales [(15%)($42,300)]	$ 6,345
Input Tax Credits:	
Current Expenses [(15%)($37,800)]	(5,670)
Capital Expenditures [(15%)($72,000)]	(10,800)
HST Payable (Refund) - Regular Method	($10,125)

Alternatively, under the Quick Method, the calculation would be as follows:

Basic Tax [(5.0%)(115%)($42,300)]	$ 2,432
Credit On First $30,000 [(1%)($30,000)]	(300)
Subtotal	$ 2,132
Input Tax Credit On Capital Expenditures [(15%)($72,000)]	(10,800)
HST Payable (Refund) - Quick Method	($ 8,668)

As the Regular Method produces a larger refund, it would be the preferable method. Note that input tax credits on capital expenditures are available, even when the Quick Method is used.

Exam Exercise Solution Twenty-One - 14 (Quick Method)

Since the security system is being amortized it is reasonable to assume it is a capital expenditure. If the Quick Method is not used, the GST payable (refund) would be calculated as follows:

GST On Sales [(5%)($63,400)]	$3,170
Input Tax Credits:	
Current Costs [(5%)($26,275)]	(1,314)
Capital Expenditures [(5%)($44,900)]	(2,245)
GST Payable (Refund) - Regular Method	($ 389)

Alternatively, under the Quick Method, the calculation would be as follows:

Basic Tax [(1.8%)(105%)($63,400)]	$1,198
Credit On First $30,000 [(1%)($30,000)]	(300)
Subtotal	$ 898
Input Tax Credit On Capital Expenditures [(5%)($44,900)]	(2,245)
GST Payable (Refund) - Quick Method	($1,347)

As the Quick Method produces a larger refund, it would be the preferable method. Note that input tax credits on capital expenditures are available, even when the Quick Method is used.

Exam Exercise Solution Twenty-One - 15 (Streamlined Input Tax Credit Method)

Using the streamlined method of accounting for input tax credits, the GST payable (refund) would be calculated as follows:

GST On Sales [(5%)($472,500 ÷ 1.05)]	$22,500
Input Tax Credits On Purchases And Capital Personal Property {[5/105][($320,000)(105%) + ($23,000)(105%)]}	(17,150)
Input Tax Credits On Real Property [(5%)($85,000)]	(4,250)
GST Payable (Refund) For The Year	$ 1,100

Exam Exercise Solution Twenty-One - 16 (Streamlined Input Tax Credit Method)

Using the streamlined method of accounting for input tax credits, the HST payable (refund) would be calculated as follows:

HST On Sales [(13%)($395,500 ÷ 1.13)]	$45,500
Input Tax Credits On Purchases And Capital Personal Property [(13/113)($254,250 + $56,500)]	(35,750)
Input Tax Credits On Real Property [(13%)($113,000 ÷ 1.13)]	(13,000)
HST Payable (Refund) For The Year	($ 3,250)

TIF Solution Twenty-One - 5A

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

A. 4

B. 7

C. 3

D. 5

E. 2

F. 8

G. 10

H. 6

The two unused definitions are as follows:

Exempt Goods And Services = 9

Registrant = 1

TIF Solution Twenty-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. 4

B. 8

C. 3 (not 9)

D. 5 (not 14)

E. 2 (not 6)

F. 10

G. 13

H. 7 (not 12)

The two unused definitions are as follows:

Exempt Goods And Services = 11

Registrant = 1

TIF Solution Twenty-One - 6

Single Stage Consumer Tax

The ultimate price to the consumer would be calculated as follows:

Vendor	Cost	Selling Price
Raw Materials Supplier		$ 500.00
Manufacturer	$ 500.00	750.00
Wholesaler	750.00	1,125.00
Distributor	1,125.00	1,687.50
Retailer	1,687.50	2,531.25

Applying the tax rate of 7 percent to the $2,531.25 selling price results in a tax of $177.19.

Turnover Tax Calculation

The turnover tax would be applied on each transfer of the product. Given this, the tax rate that would result in a total tax of $177.19 would be calculated as follows:

[($500)(X%)] + [($750)(X%)] + [($1,125)(X%)] + [($1,687.50)(X%)] + [($2,531.25)(X%)] =$177.19

[($500 + $750 + $1,125 + $1,687.50 + $2,531.25)(X%)] =$177.19

[($6,593.75)(X%)] =$177.19
X% = $177.19 ÷ $6,593.75
X% = 2.69%

As would be anticipated, because this tax is applied at each stage in the production/sale process, the required rate is lower than the 7 percent that would be applied at only the consumer level.

TIF Solution Twenty-One - 7

Calendar Quarter Test

As taxable sales did not exceed $30,000 in any of the quarters under consideration, the application of this test would not result in Name-Your-Income being required to register.

Last Four Calendar Quarters Test (Cumulative)

Application of this test requires the following analysis of the cumulative last four quarters results:

Period	Taxable Sales	Net Increase Or Decrease	Cumulative Last Four Quarters
First Quarter 2016	$ 8,500	$ 8,500	$ 8,500
Second Quarter	6,200	6,200	14,700
Third Quarter	7,400	7,400	22,100
Fourth Quarter	7,600	7,600	29,700
First Quarter 2017	8,400	(-8,500+8,400)	29,600
Second Quarter	9,200	(-6,200+9,200)	32,600

The small supplier threshold of $30,000 was exceeded in the second quarter of 2017 (April to June). As a result, Name-Your-Income will have to begin collecting GST on the first sale in the second month following the end of the quarter in which the $30,000 threshold was exceeded. This means that it will have to collect GST on the first sale in August, 2017.

Registration is required within 29 days of the first sale in August, the day GST collection is required to begin.

TIF Solution Twenty-One - 8

As sales of commercial property are taxable, HST of $650,000 [(13%)($5,000,000)] will be payable on the purchase. An input tax credit can be claimed as Total Health Inc. is a registrant and commercial use of the building exceeds 10 percent.

The input tax credit will be based on the expected use of 40 percent for zero-rated supplies (the pharmacy), resulting in an input tax credit of $260,000 [(13%)(40%)($5,000,000)]. Medical and dental services are exempt supplies. As a result, no input tax credit is available for 60 percent of the HST paid on the building.

TIF Solution Twenty-One - 9

Mrs. Archer's input tax credits would be calculated as follows:

Meals With Clients [(50%)($208)]	$ 104
Country Club Membership	Nil
Laptop (100%)	325
Automobile [(13%)($30,000)]	3,900
Total Of Input Tax Credits	$4,329

The deductibility of certain types of business costs are restricted for income tax purposes. For many of these items, there is a corresponding restriction on the ability of the business to claim input tax credits for HST purposes. In this problem, the applicable restrictions are as follows:

- The recovery of HST on meals and entertainment expenses is limited to 50 percent.
- No input tax credit is allowed for HST paid on membership fees or dues in any club whose main purpose is to provide dining, recreational, or sporting facilities.
- No input tax credits are available for HST paid on the portion of the cost or lease payment of a passenger vehicle that is in excess of the deduction limits. For vehicles purchased by a taxpayer, the limit is $30,000.

As a further note, since the laptop is used more than 50 percent for commercial activity, 100 percent of the input tax credit can be claimed. The fact that it was invoiced in December means that the input tax credit can be claimed despite the fact it was not paid for until the following quarter.

TIF Solution Twenty-One - 10

The sales are fully taxable. GST paid on the cost of balloons purchased and Operating Costs can be claimed as an input tax credit. All other items are GST exempt.

The net GST remittance for the year is calculated as follows:

GST On Sales [(5%)($69,000)]	$3,450
Input Tax Credits:	
Balloons Purchased [(5%)($12,000 - $3,000 + $4,000)]	(650)
Salaries And Wages	Nil
Operating Costs [(5%)($14,500)]	(725)
Interest On Demand Loan	Nil
Interest On Mortgage	Nil
Amortization Expense	Nil
Income Taxes	Nil
Net GST Remittance	$2,075

TIF Solution Twenty-One - 11

The HST refund for Montagne Inc. for the year would be calculated as follows:

HST Collected [(13%)($823,000 - $120,000 - $116,000)]	$76,310
Input Tax Credits:	
Purchases [(13%)($478,000 - $74,000)]	(52,520)
Amortization Expense	Nil
Salaries And Wages	Nil
Interest Expense	Nil
Other Operating Expenses [(13%)($32,000)]	(4,160)
Building [(13%)(85%)($800,000)]	(88,400)
Other Capital Expenditures [(13%)(100%)($400,000)]	(52,000)
HST Payable (Refund)	($120,770)

Notes:

- The fact that HST is paid on all purchases is not unreasonable, despite the fact that the Company provides both zero-rated and exempt supplies to its customers. Some zero-rated supplies, for example exports, involve selling items on which HST is paid. Exempt supplies could include the provision of certain types of services for which no purchases are required.
- Amortization expense does not affect the HST calculation.
- No HST is paid on salaries and wages, or interest. As a result no input tax credits are available.
- Input tax credits on real property are available based on a pro rata portion of their usage in providing taxable supplies.
- Full input tax credits are available on capital expenditures other than real property if more than 50 percent of their usage is to provide fully taxable and zero-rated supplies.

TIF Solution Twenty-One - 12

The following recommendations are based solely on the minimization of the HST payment. No consideration is given to the reduction in accounting costs available through the use of the Quick Method.

Billy Bob - Guided Fishing Services (Service Business)

The Regular Method would be preferable in this case.

Regular Method

[13%][($90,400 - $24,860) ÷ 1.13]	$7,540

Quick Method

Basic Tax [(8.8%)($90,400)]	$7,955
Credit On First $30,000 [(1%)($30,000)]	(300)
Net HST	$7,655

Bubba - Fishing Equipment Sales (Retailer)

The Regular Method would be preferable in this case.

Regular Method

[13%][($197,750 - $135,600) ÷ 1.13]	$7,150

Quick Method

Basic Tax [(4.4%)($197,750)]	$8,701
Credit On First $30,000 [(1%)($30,000)]	(300)
Net HST	$8,401

Nancy Sue - Cooking Equipment Sales (Retailer)

The Regular Method results for Nancy Sue are as follows:

Regular Method

[13%][($158,200 - $45,200) ÷ 1.13]	$13,000

While Nancy Sue is in a retail business, her costs for the current year are well below the 40 percent that is required for use of the favourable quick method rates that are applicable to retail operations. However, this test is based on sales and purchases in the previous year, information that is not available in this problem. If we assume that this 40 percent test was met in the previous year, the quick method gives a more favourable result as follows:

Quick Method - Rate For Retailers

Basic Tax [(4.4%)($158,200)]	$6,961
Credit On First $30,000 [(1%)($30,000)]	(300)
Net HST	$6,661

Alternatively, if the 40 percent test is not met, the quick method results are less favourable than the results under the Regular Method.

Quick Method - Rate For Service Providers

Basic Tax [(8.8%)($158,200)]	$13,922
Credit On First $30,000 [(1%)($30,000)]	(300)
Net HST	$13,622

Sally Ann - Individualized Cooking Courses (Service Business)

The Regular Method would be preferable in this case.

Regular Method

[13%][($107,350- $67,800) ÷ 1.13]	$4,550

Quick Method

Basic Tax [(8.8%)($107,350)]	$9,447
Credit On First $30,000 [(1%)($30,000)]	(300)
Net HST	$9,147

TIF Solution Twenty-One - 13

Part A

Using the regular calculations, the HST payable for Larkin Ltd. for the current year would be calculated as follows:

HST Collected [(13%)($103,000)]	$13,390
Input Tax Credits On Current Expenditures:	
Purchases [(13%)($63,000 + $6,000)]	(8,970)
Amortization Expense	Nil
Salaries And Wages	Nil
Rent [(13%)($24,000)]	(3,120)
Interest Expense	Nil
Other Operating Expenses [(13%)($12,000)]	(1,560)
Input Tax Credits On Capital Expenditures [(13%)(100%)($36,160 ÷ 1.13)]	(4,160)
HST Payable	($ 4,420)

Notes:

- Amortization expense does not affect the HST calculation.
- No HST is paid on salaries and wages, or interest. As a result no input tax credits are available.
- Full input tax credits are available on capital expenditures other than real property if more than 50 percent of their usage is to provide fully taxable supplies.

Part B

As Larkin's HST included taxable sales of $116,390 [(113%)($103,000)] is less than $400,000 and it is not engaged in an ineligible business such as accounting, Larkin can use the Quick Method.

Part C

The Quick Method calculations would be as follows:

Basic Tax [(4.4%)(113%)($103,000)]	$5,121
Credit On First $30,000 [(1%)($30,000)]	(300)
Total Before Capital Expenditures	$4,821
Input Tax Credit On Capital Expenditures [(13%) (100%)($36,160 ÷ 1.13)]	(4,160)
HST Payable	$ 661

In this case, the regular HST calculations are preferable as it produces a refund rather than requiring a remittance.

TIF Solution Twenty-One - 14

The car cost $29,000 before HST. Since this is less than the limit for Class 10, the total amount paid, including HST, is included in Class 10. The maximum CCA that Martin can claim for the year is as follows:

Opening UCC ($32,770 - $4,916)	$27,854
HST Rebate Claimed On Car CCA In Preceding Year	(566)
Adjusted UCC	$27,288
Class 10 Rate	30%
Maximum CCA	$ 8,186

The employee HST rebate for Martin would be calculated as follows:

Total Expenses Other Than CCA	$27,330	
HST Exempt Purchases:		
Interest	(2,200)	
Insurance	(1,400)	
Eligible Expenses Other Than CCA	$23,730	
Rate	13/113	$2,730
Eligible CCA	$8,186	
Rate	13/113	942
Employee HST Rebate		$3,672

TIF Solution Twenty-One - 15

The total input tax credit that can be claimed is calculated as follows:

Total Expenditures		$34,060
Ineligible Items		
Salaries	($4,000)	
Interest	(1,000)	(5,000)
		$29,060
Input Tax Credit Factor		5/105
Input Tax Credit To Be Claimed		$ 1,384

Note that the $1,384 input tax credit is greater than the GST paid of $1,300. The reason for the $84 ($1,384 - $1,300) discrepancy is due to the inclusion of the non-refundable provincial sales tax of $1,760 in the tax base for purposes of calculating the input tax credit [($1,760)(5/105) = $84].

This difference benefits registrants who use the streamlined input tax credit method.

The GST refund is $184 ($1,200 - $1,384).

TIF Solution Twenty-One - 16

The GST and total cost of each purchase would be calculated as follows.

Property A

As this property is a used residential unit, no GST will be payable. This means that no GST will be required and the total cost will be $346,000.

Property B

GST will be paid on the purchase price of $314,000, plus all of the improvements. However, the new housing rebate is only available on the $12,000 cost of the improvements done by the builder in addition to the purchase price. It is not available on the additional $22,000 of costs incurred by Misty.

GST Payable [($314,000 + $12,000 + $22,000)(5%)]	$ 17,400
Less: New Housing Rebate [($314,000 + $12,000)(5%)(36%)]	(5,868)
Net GST Payable	$ 11,532
Purchase Price ($314,000 + $12,000 + $22,000)	348,000
Total Cost	$359,532

Property C

As the renovations involve more than 90 percent of the interior, they will be considered substantial. Since the renovations would be done by the vendor prior to the sale, the purchase would be deemed to be that of a "new" home. As a result, the total purchase price would be subject to GST and a new housing rebate could be claimed on the total, as follows:

GST Payable [($390,000)(5%)]	$ 19,500
Less: New Housing Rebate [$6,300][($450,000 - $390,000) ÷ $100,000]	(3,780)
Net GST Payable	$ 15,720
Purchase Price	390,000
Total Cost	$405,720