Quiz 6: Chapter 12B — Due before midnight on Sunday March 22

Prepare your answers to the following questions in an MSWord document, naming the file "YourName A00number Quiz6", and submit to the Quiz Submissions folder for your set on the ShareFile.

1. On August 15, 2014, Jerry Richard transferred property to Neoncrunch Corp. in a rollover under subsection 85(1). Neoncrunch has a February 28 year end. Jerry is the sole shareholder and full-time President of Neoncrunch. What is the latest day by which rollover form T2057 must be filed in order to avoid late filing penalties? Be sure to identify any relevant authorities to support your conclusion.

2. Donald transfers land to D Corp. and makes a joint election with D Corp. under section 85 of the Income Tax Act in the amount of $60,000. The land has a cost of $60,000 and a fair market value of $220,000. Donald takes back a demand promissory note of $70,000 and redeemable, retractable preference shares worth $150,000 in value. What are the tax consequences of this transaction for both Donald and D Zcorp. Be sure to identify any relevant authorities to support your conclusion.

3. Steve plans to sell to S Ltd. a parcel of land which has a mortgage lien against it of $15,000 . S Ltd. is a taxable Canadian corporation, of which Steve owns all the shares. Steve and S Ltd. will file an election under section 85. S Ltd. will assume the mortgage. For proceeds, Steve would like to receive a non-interest bearing note for the maximum amount possible without incurring adverse tax consequences. The balance of the consideration will be in shares of S Ltd. Steve considers any tax incurred an adverse consequence. The asset has the following characteristics:

FMV	$100,000
ACB	40,000

   What is the maximum amount of the note that Steve should take? Be sure to identify any relevant authorities to support your conclusion.

4. Gamma transferred some equipment from his proprietorship to a corporation in which he owned all of the shares. The capital cost of the equipment was $20,000, its UCC before the transfer was $16,000 and it was valued at $40,000 at the time of the transfer. In order to utilize some losses of the proprietorship that were about to expire, Gamma elected a transfer price of $35,000 under subsection 85(1). What the capital cost of the property to the corporation be? Be sure to identify any relevant authorities to support your conclusion.

5. When a taxpayer sells the assets of his or her business, including accounts receivable, an election under section 22 may be made so that the disposition of accounts receivable will not constitute a capital transaction. Which of the following are necessary requirements in order for the election to be valid? Be sure to identify any relevant authorities to support your conclusion.

   A) The election is made by attaching a letter to the tax return for the year of the sale.
   B) The purchaser continues to carry on the business.
   C) All or substantially all the property used in the business is sold.
   D) Both the purchaser and the vendor must make the election.

Use the following to answer questions 6-7:

Lambda transferred a non-depreciable capital property to a corporation. The fair market value of the property was $130,000 and its adjusted cost base to him was $40,000. As consideration for the property, he received a promissory note for $20,000, 10 preferred shares with a total retraction value of $70,000 and 100 common shares worth a total of $40,000. On the transfer, he elected under subsection 85(1) at $40,000.

6. What will be the adjusted cost base of the preferred and common shares, respectively? Be sure to identify any relevant authorities to support your conclusion.

7. What will be the PUC of the preferred and common shares, respectively? Be sure to identify any relevant authorities to support your conclusion.

8. Using the elective provisions of s.85(1), Mr. Jones transfers land with an adjusted cost base of $75,000 and a fair market value of $200,000 to a new CCPC in which he is the sole shareholder. He takes back consideration which includes debt with a fair market value of $140,000 and redeemable preferred shares with a fair market value and legal stated capital of $110,000. The elected transfer price is $200,000. What will be the immediate increase in Mr. Jones's income? Be sure to identify any relevant authorities to support your conclusion.

9. Mr. Alpha owns 100% of the Class A preferred shares of an investment holding corporation of which 100% of the common shares is owned by his daughter. In this year, Alpha transferred portfolio shares that cost him $11,000 and were worth $20,000, electing at $11,000 under subsection 85(1). As consideration for the transfer, he received a promissory note for $10,000 and Class B preferred shares with a fair market value of $5,000. What will be the elected transfer price and the adjusted cost base of the Class B preferred shares, respectively? Be sure to identify any relevant authorities to support your conclusion.

10. Bruce Wallace has built a very successful health products wholesaling corporation, BW Corp, and wants now to freeze the value of his investment in the corporation so that his children can subscribe for new common shares at a nominal amount. His common shares have a FMV of $600,000, and ACB and PUC of $1,000, and they are qualified small business corporation shares. All of BW Corp's income has been eligible for the Small Business Deduction. Bruce is personally in the highest marginal tax bracket.

    Bruce intends to transfer his shares to BW Corp, electing under s.85(1) an amount of $600,000, in exchange for cash of $300,000 and preferred shares with a FMV and legal stated capital of $300,000. Bruce has never taken a capital gains deduction, and expects to offset the capital gains on this transaction with a s.110.6(2.1) deduction.

    How much tax must Bruce pay (assuming formula sheet tax rates) as a result of this transaction? Be sure to identify any relevant authorities to support your conclusion.

APPENDIX I

FMGT 7410: Formulas and Rates (Winter 2020 Ver 3)

The formulas on this sheet may not be complete and may not apply to all fact patterns. It is your responsibility to understand in each instance what the limitations of each formula may be. On an exam, be sure to identify any formula you refer to by the relevant ITA provision. Simply quoting a formula without referring to the relevant provision is confusing to the examiner, and may deny you credit for your calculation.

Assumed tax rates for analytical purposes (based on average provincial 2019 rates)

Personal tax rates (highest marginal tax rate):

a) Interest: 50%
b) Eligible dividends: 35%
c) Non-eligible dividends: 43%
d) Capital gains: 25%

Corporate tax rates (reflecting average provincial rates - 2019):

a) Full rate taxable income (combined 15% fed. and 12% prov.): 27%
b) M&P (combined 15% fed. and 10% prov.): 25%
c) CCPC (ABI < $500,000): (combined 9% fed. and 4% prov.): 13%
d) Personal Service Business Income (including 12% prov.): 45%
e) Aggregate Investment Income (combined 38.67% fed. and 12% prov.): 50.67%

Dividend Gross Up and Dividend Tax Credits - 2019:

a) Gross up on eligible dividends: 38%
b) Gross up on non-eligible dividends (2019) 15%
c) Combined federal (6/11 of GU) and provincial DTC on eligible dividends: 90% of GU
d) Combined federal (9/13 of GU) and provincial DTC on non-eligible dividends: 100% of GU

Legislated changes to federal rates for SBD, and Non-eligible Gross-up and Dividend Tax Credits:

	2017	2018	2019
a) SBD (% of Taxable Income)	17.5%	18%	19%
b) Non-eligible GU (on actual dividend paid)	17%	16%	15%
c) Non-eligible Federal DTC (% of GU)	21/29	8/11	9/13

Personal Tax formulae:

CGR = CG x [Lesser of: (a) (4 – YE since Year of transaction) ÷ 5; (b) (OS Proceeds ÷ Total Proceeds) [per s.40(1)(a)(iii)]

CGD = Lesser of (i) ULM; (ii) AGL; and (iii) CGL [per s.110.6(2.1)]

Where (per 110.6(1):

ULM = ($866,912 ÷ 2) - ∑previous CGDs adjusted to the current inclusion rate

AGL = TCG on qualified properties not otherwise shielded from tax by current year ABILs, or the sum of current year ACLs and NCLs in excess of TCG on non-qualified properties.

CGL = [∑ (post 1984) TCGs on qualified properties] - [∑ (post 1984) ABILs] - [∑ (post 1984) ACLs and NCLs used to shield TCGs on qualified properties] – [∑previous CGDs] – [current year CNIL]

CNIL = Greater of: (i) 0 ; and (ii) [∑ (post 1987) InvExp] – [∑(post 1987) InvInc]

InvExp = ∑ property expenses + ∑ NCL deducted that were used to shield TCG on non-qualified properties

InvInc = ∑ property income + ∑ net TCG on non-qualified properties

Corporate tax calculation formulae (2019):

SBD = 19% [lesser of: (a) Net Cdn ABI; (b) TI – 100/28 FNBTC – 4 FBTC; (c) BL] [per s.125(1)]

MPPD = 13% [lesser of: (a) MPP – SBD Amount (b) TI – (SBD Amount + 4 FBTC + AII)] [per s.125.1(1)]

MPP = (Net Cdn ABI) x (MC + ML) ÷ (TC + TL) [per Reg. 5200]
Where **MC** = (100/85) x [(10% x CC) + Rent] of depreciable assets used in qualified activities
And **ML** = (100/75) x labour costs used in qualified activities
And **TC** = [(10% x CC) + Rent] of all depreciable assets]
And **TL** = total labour costs

GRR = 13% [TI – MPPD Amount – SBD Amount – AII -- PSBI] [per s.123.4(2)]

AII = [Net TCG – NCL + Income from property – Dividends deducted in Div C] [per s.129(4)]

Adj AII = AII – Net TCG on active assets + NCL + Portfolio Dividends [per s.125(7)]

BL Reduction = Greater of: (a) $1 for every $10 that TCC> $10 million; (b) $5 for every $1 that PY Adj AII > $50,000 [per s. 125(5.1)

ART = 10-2/3% [lesser of: (a) AII; (b) TI – SBD Amount] [per s.123.3]

Part IV Tax = [38-1/3% x (unconnected dividends] + (payer's refund related to connected dividend) [per s.186]

GRIP = (PY GRIP) + (72% [TI – SBD Amount – AII]) + (Elig Div Rcv'd) – (PY Elig Div Paid) – (72% of losses carried back to 3 prior years reducing full rate taxable income) [per s.89(1)]

CDA at any time in the year **=** PY Balance + TCG – ACL + net life insurance + CD received - CD paid [per s.89(1)]

Refundable Part I Tax = lesser of: (a) [(30-2/3% AII) – (FNBTC – 8% FNBI)];
(b) [30-2/3% (TI – (SBD Amount + 100/(38-2/3) FNBTC + 4 FBTC))]; (c) Part I tax [per s.129(4) "NERDTOH"]

NERDTOH = (PY NERDTOH) + (Refundable Part I Tax) + (Part IV on Connected Dividend refund from NERDTOH) – (PY NERDTOH Div Refund) [s.129(4)]

ERDTOH = (PY ERDTOH) + (Part IV on unconnected dividends) + (Part IV on Connected Dividends that triggered an ERDTOH Div refund) – (PY ERDTOH Div refund) [s.129(4)]

Dividend Refund = Sum of:
(a) Lesser of: (A) 38-1/3% of eligible dividends paid; (B) CY ERDTOH;
(b) Lesser of: (C) 38-1/3% of non-eligible dividends; (D) CY NERDTOH;
(c) If (C) > (D): Lesser of: (i) (C – D); (ii) (B – A). [s.129(1)]

Rollover and Reorganization Formulae

s.85 rollover of eligible properties to a taxable Canadian corporation

minimum EA = Greater of (A) Boot and (B) the lesser of (a) FMV, (b) ACB, (c) UCC of class [per s.85(1)(e.3)]

maximum EA = FMV [per s.85(1)(c)]

POD = EA

PUC reduction = LSC(new) – (EA – Boot). (allocated proportional to LSC of classes issued) [per s.85(2.1]

PUC(new) = LSC – PUC reduction [per s.85(2.1]

ACB: PS (new) = lesser of (a) EA - NSC (b) FMV:PS [per s.85(1)(g)]

ACB: CS (new) = EA –NSC - FMV:PS [per s.85(1)(h)]

Gift Rule:

EA(adjusted) = EA(original) + Gift [per s.85(1)(e.2)]

ACB: PS (new) = lesser of (a) EA(original) - NSC (b) FMV:PS [per s.85(1)(g)]

ACB: CS (new) = EA(original) - FMV:PS [per s.85(1)(h)]

PUC(adjusted) = normal 85(2.1) rules using the EA(adjusted) [per s.85(2.1]

s.85 election in respect to a rollover on the redemption of the issuer's shares

POR(old) = NSC + PUC(new) [per s.84(5)]

DD = POR(old) – PUC(old) [per s.84(3)]