

Chapter 11 Self-Study Problems

Solutions are available in the Study Guide.

SSP 11-1 Allowable Business Investment Losses

During 2018, Miss Lynn Atwater invested \$170,000 to acquire 100% of the common shares of a corporation specializing in pet food products. The company was a Canadian controlled private corporation (CCPC) with a fiscal period ending on December 31. All its property assets were used in an active business carried on in Canada.

In 2018 and 2019, the company enjoyed profits but did not pay any dividends. In 2020, it began to experience serious financial difficulties. On July 15, 2021, the company was forced into bankruptcy by its creditors and it is clear to Miss Atwater that, after the claims of the creditors have been settled, her shares will be worthless. The company was dissolved in 2022 after all creditor claims had been settled for a few cents on the dollar. Miss Atwater did not receive anything for her shares when the company dissolved. The company qualified as a small business corporation.

Other financial data for Miss Atwater for the years ending December 31, 2020, and December 31, 2021, are as follows:

	2020	2021
Rental income	\$34,200	\$35,200
Interest income	4,000	4,200
Basic personal tax credit amount	13,229	13,808

The only tax credit available to Miss Atwater in either year is the basic personal credit. Miss Atwater had no income for 2018 and 2019. At the beginning of 2019, she did not have any loss carry forwards from previous years. Miss Atwater has not made any use of her capital gains deduction in any year prior to 2021.

Required: Determine Miss Atwater's optimum taxable income for the years ending December 31, 2020, and December 31, 2021. In your solution, consider the effect of the basic personal credit. Indicate any loss carry over at the end of either year and the rules applicable to claiming the particular loss carry over.

SSP 11-2 Loss Carry Overs—Individual

Mr. Dale Brook provides you with the following financial information for the years 2018 through 2021:

2018 During this year, Dale starts a new business which, during its first year of operations, has business income of \$19,800. In addition, because of his love of the outdoors, he begins to carry on a farming business on a part-time basis. The farming business experiences a loss of \$11,000 in its first year of operation. Using the proceeds of an inheritance, he makes a number of investments in common shares during the year. In 2018, these investments pay

\$1,870 in eligible dividends. As the result of dispositions in the year, he realizes \$1,320 in capital gains and \$4,620 in capital losses.

2019 This year Dale's business has a business loss of \$15,400. However, the farming business reports income of \$2,200. Also during 2019 he receives \$2,351 in eligible dividends and realizes capital gains of \$2,200. He has no capital losses during the year.

2020 Dale's business income for the year is \$33,000. In addition, the farming business reports income of \$3,465. He receives eligible dividends of \$3,160 and realizes capital gains of \$4,400. Once again, no capital losses are realized.

2021 Dale's business experiences a business loss of \$20,900. In addition, his farming business has a loss of \$2,200. Although he receives \$5,140 in eligible dividends, he is forced to sell some investments for much-needed funds and realizes capital gains of \$4,950 and capital losses of \$15,950.

Because of the nature of his farming activities, Dale's farm losses are restricted. All of the dividends received are from taxable Canadian corporations.

When he has a choice, he would like to deduct the maximum amount of any net capital loss carry overs and carry back any losses to the earliest possible year. Prior to 2018, Dale was a full-time student with no federal income tax payable. This means that it would not be useful to carry back any type of loss to years prior to 2018.

Dale requires \$15,400 in taxable income each year to fully utilize his available tax credits. In applying carry over amounts, Dale's taxable income should not be reduced below \$15,400.

Required:

Calculate Dale's minimum net income and taxable income for each of the four years. Indicate the amended figures for any years to which losses are carried back. Also indicate the amount and types of loss carry overs that would be available at the end of each year.

SSP 11-3 ABILs and Lifetime Capital Gains Deduction

At the beginning of 2021, Mr. Andy Barkin had a 2016 net capital loss carry forward of \$13,700 [(1/2) (\$27,400)]. During 2021, Mr. Barkin had employment income of \$115,000. Additional information for the year 2021 is as follows:

- Mr. Barkin sold shares that are QSBC shares for \$328,000. The ACB of the shares was \$153,000. Selling costs were \$2,000.
- At the end of the year, Mr. Barkin had a CNIL balance of \$4,800.
- Mr. Barkin sold shares of a CCPC that qualified as QSBC shares for \$55,000. The ACB of the shares was \$228,000. Selling costs were \$1,000.

Mr. Barkin realized capital gains of \$38,000 in 2010 and \$21,000 in 2013. Both capital gains resulted from the sale of QSBC shares with the full capital gains deduction claimed for both. Mr. Barkin has only used the capital gains deduction for those capital gains prior to 2021.

Mr. Barkin would prefer to make maximum use of his capital gains deduction prior to deducting

the 2016 net capital loss.

Required: Calculate Mr. Barkin's minimum net income and taxable income for 2021. Provide all of the calculations required to determine the maximum capital gains deduction he can claim for the year.

SSP 11-4

Tax on Split Income

In the following three cases, one or more individuals receive dividends from a private company.

For each individual, determine whether the amounts received are split income. Explain your conclusion.

CASE A Marty and Miranda have been married for a number of years. They are both in their mid-30s. During their time together, Marty has created a successful manufacturing business. He devotes all of his working hours to the operations of the corporation. Miranda has never been involved in the operation of the business, preferring to be a stay-at-home mother and taking care of their three children.

When the business was incorporated, all of the shares were issued to Marty and Miranda, with 100,000 Class A shares going to Marty and 100,000 Class B shares going to Miranda. The two classes of shares have equal fair market values and equal voting rights.

During 2021, \$200,000 in dividends are paid on the Class A shares and \$250,000 in dividends are paid on the Class B shares.

CASE B Jerome initially owned all of the shares of a private corporation that manufactures a variety of items on a contract basis. From 2014 through 2019, his son, Jeff, worked full time for the corporation, receiving a salary that allowed his family to live comfortably. However, he has concluded that he would be much more valuable to the business if he obtained a degree in engineering, a view that is shared by his father. As a result, Jeff enrolls in a four-year engineering degree program at a local university, beginning in January 2020.

Jeff's studies prevent him from having an active role in the business in either 2020 or 2021.

In order to assist him financially during his engineering studies, Jerome issues a second class of shares to Jeff. Jeff uses his accumulated savings to pay for the shares.

During 2021, \$125,000 in dividends are paid on Jerome's shares and \$75,000 in dividends are paid on Jeff's shares. Jeff is 29 years old at the end of 2021.

CASE C Charles and his common-law partner, Clifford, each own 50% of the shares of Chill Inc., a Canadian private corporation involved in manufacturing. All of the shares have the same voting rights. Both Charles and Clifford are 35 years old. Since the inception of the business over 10 years ago, Charles has worked full time in the business. As Clifford has a full-time position in retail, he has never participated in the activities of Chill Inc.

During 2020, Chill Inc. pays a total dividend of \$200,000, with \$100,000 going to Charles and \$100,000 going to Clifford.

SSP 11-5 Transfer of Credits and Pension Income Splitting

Mr. and Mrs. Hanson have been retired for several years. They are both in their early 70s, residents of Canada, and rely on pension income to provide for most of their needs. More specifically, the components of their income for the year ending December 31, 2021, are as follows:

	Mr. Hanson	Mrs. Hanson
Old Age Security (OAS)	\$ 7,400	\$7,400
RRIF income	50,000	Nil
Receipts from registered pension plan	25,380	1,680
Eligible dividends received from Canadian public corporations (100%)	800	180
Interest on government bonds	500	4,359
Charitable donations	600	200
Capital gain on sale of shares	N/A	375
Capital loss on sale of shares	N/A	725

Required:

- A. Assume that Mr. and Mrs. Hanson do not elect to use pension income splitting. Determine the net income and taxable income for both Mr. and Mrs. Hanson, and the maximum federal tax credits that will be available to Mr. Hanson for the 2021 taxation year. Also indicate the amount and types of any loss carry overs that would be available to Mr. and Mrs. Hanson for 2021.
- B. If Mr. and Mrs. Hanson jointly elect to split the pension income, what objectives should they try to accomplish with the pension income split? (No calculations are required.)

SSP 11-6 Comprehensive Tax Credits with Dividend Transfer

Mr. and Mrs. Dalton have been retired for several years. They are both in their early 70s, residents of Canada, and rely on pension income to provide for most of their needs. Mr. Dalton is sufficiently disabled that he qualifies for the disability tax credit (he has the required signed Form T2201).

The components of their income for the year ending December 31, 2021, are as follows:

	Mr. Dalton	Mrs. Dalton
Old Age Security benefits	\$ 7,400	\$ 7,400
Receipts from registered pension plan	Nil	62,000
RRIF receipts	1,640	12,420
Interest on government bonds	1,420	2,580
Eligible dividends received	3,420	460
Charitable donations	350	960

Assume that Mr. and Mrs. Dalton do not jointly elect to use pension income splitting.

Required:

- A. Calculate Mr. and Mrs. Dalton's 2021 minimum net federal tax payable and any social benefits repayment assuming that no transfer of dividends is made under ITA 82(3).
- B. Determine whether a transfer of dividends under ITA 82(3) would be permissible.
- C. Calculate Mr. and Mrs. Dalton's 2021 minimum net federal tax payable and any social benefits repayment assuming that all of Mr. Dalton's dividends are transferred to Mrs. Dalton under ITA 82(3). Comment on whether the dividend transfer should be done.

SSP 11-7**Alternative Minimum Tax**

Walter, Wendel, and Winston Lawson are brothers. For 2021, they are all concerned about the impact of the AMT on the amount of tax they will have to pay. In order to help them prepare for any additional tax payments they may encounter, they have provided you with the following estimates of the various types of income and deductions they expect in 2021:

	Walter	Wendel	Winston
Employment and business income	\$52,100	\$42,300	\$ 41,300
Eligible dividends received from taxable Canadian corporations	82,300	Nil	12,300
Taxable capital gains	36,400	Nil	226,550
Capital gains deduction claimed	36,400	Nil	221,500
RRSP contributions	Nil	27,000	Nil

Prior to 2021, Wendel has made no contributions to his RRSP, leaving him with contribution room of \$120,000. However, in 2021, as the result of winning a lottery prize, he is able to contribute \$27,000. He plans to deduct the entire amount of the contribution.

All taxable capital gains resulted from the disposition of QSBC shares.

Assume the only tax credits available to the Lawson brothers are their basic personal tax credits and dividend tax credits related to dividends received. Ignore any potential tax credits for EI and CPP contributions, as well as the Canada employment credit.

Required:

Calculate the minimum regular 2021 net federal tax payable for each of the three Lawsons, as well as the AMT amount.

SSP 11-8**Comprehensive Personal Tax Payable**

Ms. Linda Worthmore is employed by Intra Graphics Inc. and, for the year ending December 31, 2021, she had a gross salary of \$73,532. The following amounts were withheld by her employer during the year:

CPP contributions	\$3,166
EI premiums	890
RPP contributions	1,233
Donations to registered charities	342

During 2021, Intra Graphics Inc. paid the following amounts on behalf of Ms. Worthmore:

Premium for private drug plan	\$ 415
Premium for private extended health care	235

Ms. Worthmore is married and lives with her husband, Mr. John Dalton. During 2021, Mr. Dalton received \$1,065 in interest on a five-year term deposit.

Mr. Dalton was a full-time student at a designated educational institution during four months of the year. His tuition fees, which were paid by Ms. Worthmore, were \$2,300 and he agreed to transfer his unused tuition credit to her. His fees for dental work totalled \$1,056 for 2021 and were paid by Ms. Worthmore.

Ms. Worthmore and her husband have three children, all of whom live at home. Relevant information on these children is as follows:

Joyce is 7 years of age and has no income of her own. During 2021, Ms. Worthmore was required to pay \$2,200 in medical expenses for Joyce.

Jayne is 14 years of age and had earnings from part-time employment of \$1,225. On March 15, 2021, Ms. Worthmore gave her daughter 27 shares of a publicly traded Canadian company. The shares had cost Ms. Worthmore \$18 per share, and at the time of the gift they were trading at \$27 per share. The shares paid no dividends during 2021 and were still held by Jayne on December 31, 2021.

June is 17 years of age and, during 2021, had income of \$5,000. In July 2021, June was involved in a serious accident. As a result of the accident, Ms. Worthmore was required to pay \$9,850 of eligible medical expenses on June's behalf.

Other Information:

1. In 2020, Ms. Worthmore gave her husband 52 shares of a publicly traded Canadian company. Ms. Worthmore had acquired the shares at \$12 per share and, at the time of the gift, the shares were trading at \$32 per share. She did not elect to avoid the rollover of ITA 73(1). On June 15, 2021, the shares paid an eligible dividend of \$3.50 per share. On August 31, 2021, Mr. Dalton sold these shares for \$56 per share.
2. Ms. Worthmore is the sole shareholder of Lindworth Inc. This Canadian controlled private corporation (CCPC) has a December 31 year end and, during 2021, paid non-eligible dividends in the total amount of \$4,325 to Ms. Worthmore. As an employee of this company, she received a salary of \$2,500 for the year. No CPP or EI payments were deducted from the salary.
3. Under the provisions of a court decree, Ms. Worthmore pays spousal support to her former husband in the amount of \$225 per month.
4. During 2021, Ms. Worthmore made contributions to an RRSP in the amount of \$7,500. A pension adjustment of \$6,351 was reported on her 2020 T4. Assume that her 2020 earned income equals her 2021 earned income. At the end of 2020, she has no unused RRSP deduction room or undeducted RRSP contributions.
5. During 2021, Ms. Worthmore sold 122 shares of Lackmere Ltd. at a price of \$86 per

share. Ms. Worthmore owned a total of 300 shares of this company, having acquired 122 shares at a price of \$92 and the other 178 at a price of \$71 per share. The shares of Lackmere do not qualify for the capital gains deduction.

6. During 2021, Ms. Worthmore sold land to her older brother for \$10,000. The land had a fair market value of \$28,000 and had been acquired by Ms. Worthmore for \$10,000 four years ago. The land had been rented out to local farmers for agricultural use. The land is not a qualified farm property for the purposes of the capital gains deduction.
7. During 2021, Ms. Worthmore made contributions to registered political party in the amount of \$100.

Required:

- A. Calculate Ms. Worthmore's minimum net income for 2021. Provide separate totals for employment income, property income, taxable capital gains, and other income and deductions.
- B. Calculate Ms. Worthmore's minimum taxable income for 2021.
- C. Calculate Ms. Worthmore's minimum net federal tax payable for 2021. Ignore GST/HST & PST considerations, as well as income tax payments that were made by Ms. Worthmore through instalments or withholding.

SSP 11-9

Comprehensive Personal Tax Payable

The following information relates to Mr. Michael Slater for the year ending December 31, 2021:

Receipts

Gross salary from Slater Inc.		\$ 35,000
Revenue from farming		36,000
Drawings from non-farming business		9,000
Interest on savings account		4,450
Winnings from gambling		1,600
CPP benefits		5,100
Loans to friends:		
Interest received	\$12,000	
Principal repaid	<u>21,000</u>	33,000
Cash inheritance from deceased aunt		25,000
Eligible dividends from Canadian public corporations (100%)		44,000
Dividends from U.S. corporations—Net of 15% withholding (Canadian dollars)		8,500
Proceeds from sale of land		111,500
Total receipts		\$313,150

Disbursements

Farm expenses	\$ 45,000
Personal funds invested in non-farming business	42,000
Interest paid on bank loan	2,300

Funds spent gambling	1,000
Life insurance premiums	11,000
Mortgage payments on personal residence	15,000
Charitable donations	2,700
Contributions to registered political party	500
Total disbursements	\$119,500

Other Information:

1. Mr. Slater is 71 years old. His wife is 61 and has been blind for several years. She is in ill health and has no income of her own.
2. Mr. Slater owns 45% of the shares of Slater Inc., the corporation that employs him. As a result, no EI premiums were withheld. Since Mr. Slater is over 70 years old, he does not have CPP deductions from salary or from business income.
3. Mr. Slater's organic farming operation is a part-time business that he started one year ago and carries on as a sole proprietorship, believing organic produce would improve his wife's health. With his vast business experience, he is confident he can make the operation profitable within another year.
4. On May 1, 2021, Mr. Slater began a second non-farming business that he carries on as a sole proprietorship. The business has a calendar year fiscal period ending December 31. The proprietorship had business income of \$28,300 for income tax purposes for the period May 1 to December 31, 2021. A bank loan was obtained to capitalize the business. All the interest relates to that bank loan and no interest expense was deducted in the calculation of business income.
5. The land that was sold during 2021 was purchased at a cost of \$23,000 three years ago. Mr. Slater had intended to build a cottage on it.
6. For the last several years, Mr. Slater has had consistently high levels of income and, as a consequence, the full \$7,400 of Old Age Security benefits have been withheld. However, as he did apply for and receive OAS benefits in a previous year, the government continues to issue an information slip, a T4A(OAS), which shows both the taxable OAS paid and the OAS withheld as \$7,400.

Required: Calculate Mr. Slater's minimum net federal tax payable and any other amounts owing (including any social benefits repayment) for the year ending December 31, 2021. Ignore GST/HST & PST considerations, as well as any income tax payments that were made by Mr. Slater through instalments or employment income withholding. Include in your solution any carry overs that are available for 2021.

SSP 11-10**Death of an Individual**

On June 3, 2021, Mrs. Andrea Steele died unexpectedly. She was 53 years old. Her husband, aged 29, was a man with little experience in financial matters. He has asked you to assist him with the administration of Mrs. Steele's estate. After working with her records for several days, you have accumulated the following information:

1. At the beginning of 2021, Mrs. Steele has a 2018 net capital loss carry over balance of

\$76,500.

2. During 2021, but prior to the date of her death, Mrs. Steele's investments paid eligible dividends of \$1,090. In addition, she had Canadian source interest income of \$2,025 during this same period.
3. Mrs. Steele was the sole proprietor of a successful boutique that had been in operation for eight years. The fiscal period of the business ends on December 31. From January 1, 2021, until the date of Mrs. Steele's death, the business had business income for tax purposes of \$55,200. The FMV of the depreciable property of the boutique at the time of Mrs. Steele's death was \$4,800 greater than the UCC but not more than the capital cost.
4. In connection with the boutique, Mrs. Steele paid Mr. Steele wages of \$425 during the period January 1, 2021, through June 3, 2021. The wages were paid for assistance in handling the business inventory. Mr. Steele's only other income for the year was \$2,100 in interest on a group of mortgages, which had been given to him as a gift by Mrs. Steele in 2018.
5. Mrs. Steele had a rental property that she had owned for many years. Rents received in 2021, prior to her death, amounted to \$41,200, with expenses totalling \$24,650. The UCC of the building was \$144,800 on January 1, 2021. The building had been purchased for \$183,000. At the time of Mrs. Steele's death, the appraised FMV of the building was \$235,000. The land on which the building is situated had a cost of \$92,000 and a FMV of \$164,000 at the time of Mrs. Steele's death.
6. Other properties that were owned by Mrs. Steele at the time of her death were as follows:

Shares In AGF Industries Mrs. Steele purchased \$10,600 shares of AGF Industries, Canadian public company. The FMV at the time of Mrs. Steele's death was \$7,900.

Shares In Rolston Inc. Mrs. Steele purchased \$36,800 shares of Rolston Inc., also a Canadian public company. The FMV at the time of Mrs. Steele's death was \$169,400.

Painting A painting Mrs. Steele had purchased for \$8,000 had a FMV of \$37,000 at the time of her death.

Residence Mrs. Steele owned the family home. It had been purchased at a cost of \$409,400. At the time of her death, the appraised value of the home was \$544,000.

7. Mrs. Steele's will provided that the shares in AGF Industries and Rolston Inc., the painting, and the boutique be left to Mr. Steele. The family home and the rental property were left to Mrs. Steele's 27-year-old daughter.

Required: Calculate Mrs. Steele's minimum net income, taxable income, and net federal tax payable for 2021. Ignore any CPP liability.

SSP 11-11

Comprehensive Personal Tax Payable

Mr. Daniel Tong is employed as a project manager for Portus Ltd., a Canadian public corporation. He is married and has two children. The younger child is 16 and the older child is 19. Mr. Tong has requested that you assist him in the preparation of his 2021 income tax return. Relevant financial

information for 2021 is as follows:

1. Mr. Tong received a gross salary of \$78,000 for the year. From this amount, Portus Ltd. deducted CPP contributions of \$3,166, EI premiums of \$890, and company RPP contributions of \$3,900. In addition, in February 2021 Portus Ltd. paid Mr. Tong a \$6,000 bonus based on his 2020 work performance. A 2021 bonus of \$9,500 based on his 2021 work performance was paid to him on March 1, 2022.
2. In addition to his salary, Portus Ltd. paid the following employee benefits on Mr. Tong's behalf:

Company RPP contributions	\$2,300
Group term life insurance premium (\$90,000 coverage)	650
Dental insurance premium	625

3. Mr. Tong has the full use of a company automobile that Portus Ltd. leases for an annual payment of \$5,200. Portus Ltd. paid all of the \$4,300 in operating costs. During the year, Mr. Tong drove the car 21,000 kilometres, of which 7,000 kilometres were for employment purposes and the remaining 14,000 kilometres were for personal use.
4. Mr. Tong's employment contract requires that he work on a full-time basis from an office in his home. Portus Ltd. pays Mr. Tong an annual allowance of \$2,400 to cover his expenses for the office and equipment. The home office occupies 30 square metres of his 300 square metre home. During the year, he incurred the following expenses:

Home Expenses (100%):

Utilities	\$2,100	
Maintenance	750	
Insurance	820	
Property tax	2,500	
Mortgage interest	<u>7,830</u>	\$14,000
Office supplies		230
Computer and peripherals purchase (100% employment use)		<u>2,700</u>
Total expenditures		\$16,930

5. During the year, Mr. Tong took his children to visit their grandparents using airline tickets acquired through frequent flyer points accumulated while he travelled on company business. The tickets were valued at \$1,300.
6. On December 21, 2021, Mr. Tong sold all of his 800 Class A common shares of Global Inc., a public corporation, for proceeds of \$8,600. The shares were acquired for \$11,000. On January 10, 2022, on the advice of his broker, he acquired 1,000 Class A common shares of Global Inc. for \$5,800.
7. Mr. Tong participates in Portus Ltd.'s stock option plan. In January 2021, he received options to purchase 2,500 shares at \$12 per share. At this time, the shares were trading for \$12 per share. He exercises the options in May 2021, when the shares are trading for \$15 per share using funds from a bank loan to pay the option price. During

2021, he paid \$1,200 interest on the bank loan.

8. In September 2021, Mr. Tong received a \$4,500 eligible dividend on his Portus shares. He used the funds to purchase 250 more Portus shares at \$18 per share. In November 2021, Mr. Tong sold 1,250 shares of Portus Ltd. at \$21 per share.
9. In 2020, Mr. Tong contributed \$4,300 to a spousal RRSP. His wife had not previously contributed to an RRSP. In August 2021, Mr. Tong's wife withdrew \$1,000 from the RRSP to fund a jewellery purchase. Mrs. Tong had no income in 2021. On February 10, 2021, Mr. Tong contributed another \$8,000 to the spousal RRSP.
10. At the beginning of 2021, Mr. Tong had undeducted RRSP contributions carried forward from 2020 of \$2,200. Mr. Tong's 2020 earned income was \$61,500. Because he was only admitted to his employer's pension plan at the beginning of 2021, he has no 2019 PA.
11. Mr. Tong's oldest child, Marion, is 19 years of age. During the year, she attended university on a full-time basis for eight months, had interest income of \$3,000, and earned a scholarship of \$10,000. Mr. Tong paid Marion's tuition fees of \$7,150. Any unused tuition credit is available to be transferred to her father.
12. Mr. Tong purchased a sports car for \$2,500 on February 20, 2021, with the intent of restoring it for resale. He rebuilt the car and sold it to a collector for \$14,500 on April 10, 2021. He incurred costs of \$8,100 for new parts and supplies.
13. Mr. Tong has a 2014 net capital loss balance of \$2,500, a 2016 net capital loss of \$6,000, and a 2017 net capital loss of \$3,000. He has not been able to deduct any of these losses prior to 2021.

Required:

- A. Determine Mr. Tong's minimum net income and taxable Income for 2021.
- B. Based on your answer to Part A, calculate Mr. Tong's minimum net federal tax payable for 2021 before consideration of any income tax withheld by his employer. Include in your solution any amounts available for carry forward by Mr. Tong or his family at the end of 2021. In preparing the required information, ignore any GST/HST & PST considerations.

Chapter 12 Self-Study Problems

Solutions are available in the Study Guide.

SSP 12-1

Corporate Net Income Reconciliation

One of your assistants has been calculating net income for the Sanklee Company. For both accounting and tax purposes, the company uses a December 31 year end. Your assistant has been able to complete most of the required reconciliation schedule (T2 Schedule 1). However, there are a number of items that he would like you to review. The items are as follows:

1. The company has recorded amortization expense in its accounting records of \$254,000. The maximum deductible CCA for the taxation year is \$223,000.
2. The company has recorded interest expense of \$57,000. The adjustment to the bond payable premium account resulted in a reduction to interest expense for the year of \$2,000.
3. On August 12 of the current year, the company sold a limited life patent with an original cost of \$80,000 for \$120,000. In the accounting records, the patent had a carrying value of \$53,000. It was a class 44 property and, at the end of the year, there is a positive balance in this class with other property remaining in the class at year end. Only \$72,000 of the \$120,000 sales price is received in cash, with the remainder to be paid at the end of the following taxation year.
4. During the year, the company paid \$8,000 for two memberships in the Ottawa Ritz Golf and Country Club. The two company executives that hold the memberships billed the company a total of \$12,000 for entertaining clients at this club. Both of these amounts were deducted in the company's accounting records.
5. During the year, the company made charitable donations of \$11,000. This amount was deducted in their accounting records.
6. At the beginning of the current year the UCC of class 10 was nil. During the year, the company sold the one remaining class 10 property for \$23,000. The capital cost of the property was \$50,000 and its carrying value in the accounting records at the time of sale was \$39,000. No other class 10 properties were acquired during the current year.

Required: For each of the items listed, indicate the addition to and/or deduction from accounting net income that would be required in the calculation of the minimum net income for tax purposes. Explanations for the adjustments are not required and no calculation of the total net income is required.

SSP 12-2

Reconciliation

Hartman Ltd. has a December 31 year end. It has been determined that, for the 2021 taxation year, the company's accounting net income, determined in accordance with Accounting Standards for Private Enterprises (ASPE), is \$362,450. Additional information was available for preparing the corporation's T2 reconciliation Schedule 1.

1. During 2021, the company deducted a \$45,000 charitable donation. The donation was

depreciable property with a UCC of \$36,500 and a capital cost of \$42,000. The carrying value of the property in the accounting records was \$38,000.

2. Amortization expense for the year was \$32,450. The company intends to deduct the maximum CCA for the year of \$27,650.
3. At the beginning of 2021, the company had a liability for estimated warranties of \$8,460. During the year, warranty costs were incurred in the amount of \$9,420 and, at the end of the year, the remaining warranty liability was estimated to be \$10,470.
4. During 2021, the company sold temporary share investments in public companies for \$12,320. The ACB and carrying value for accounting purposes of the investments were both \$12,870.
5. During 2021, the company deducted \$30,000 in bond interest, which included \$2,600 of bond discount amortization.
6. During the year, the company sold depreciable property with a capital cost of \$189,000 and a carrying value of \$107,000 for cash proceeds of \$92,190. No property remained in the class at the end of the year. At the beginning of the current year, the UCC balance in the CCA class was \$101,770.

Required: For each of the six situations, indicate the adjustment(s) that would be required to reconcile the company's \$362,450 accounting net income to minimum net income for tax purposes. Explanations for the adjustments are not required and no calculation of the total net income for tax purposes is required.

SSP 12-3

Corporate Loss Carry Forwards

At the beginning of the 2021 taxation year, Dontar Ltd. has a 2018 net capital loss carry forward of \$42,300, a 2019 non-capital loss carry forward of \$33,500, and unused charitable donations from 2020 of \$3,500.

During the 2021 taxation year, Dontar's records show the following results (all amounts are based on the relevant tax rules):

Business loss	\$126,000
Taxable capital gains	15,600
Allowable capital losses	3,450
Charitable donations	2,600
Taxable eligible dividends	22,300

It is the policy of the company to minimize net capital loss balances prior to using any other type of carry over balance.

Required: Calculate the company's minimum net income and taxable income for its 2021 taxation year. Indicate any balances available for carry forward to subsequent years.

SSP 12-4

Corporate Loss Carry Forwards—Four Years

Linden Industries Inc. began carrying on business in 2018 and has a December 31 fiscal year end. While it was fairly successful in its first year of operation, excessive production of an

unmarketable product resulted in a large business loss for 2019. Profits have returned in 2020 and 2021.

The relevant Division B income and loss figures, along with charitable donations made during the years under consideration, are as follows:

	2018	2019	2020	2021
Business income (loss)	\$95,000	(\$205,000)	\$69,500	\$90,000
Capital gains (losses)	(10,000)	(14,000)	9,000	10,000
Dividends received	12,000	42,000	28,000	32,000
Charitable donations	21,400	4,600	8,000	22,000

All of the dividends received are taxable dividends from taxable Canadian corporations. It is the policy of the company to minimize its net capital loss carry forward balance.

Required: For each of the four years 2018 through 2021, provide the following information:

- The minimum net income and taxable income that would be reported for Linden Industries. Indicate the amount and type of any current year losses that are available for carry back or carry forward.
- The revised figures for any years to which losses are carried back.
- An analysis of the amount and type of carryovers that would be available at the end of the year.

SSP 12-5

Geographical Allocation of Income

Brawn Inc. has permanent establishments in Manitoba, Ontario, Quebec, and the United States.

During the current year, the company had total wages and salaries of \$2,465,000 and gross revenues of \$6,260,000. These were distributed among the locations where the company has operations in the following manner:

Province	Wages and Salaries Accrued	Gross Revenues
Manitoba	\$ 369,750	\$1,252,000
Ontario	616,250	1,565,000
Quebec	986,000	2,191,000
United States	493,000	1,252,000
Total	\$2,465,000	\$6,260,000

For the current taxation year, the company's taxable income is \$1,467,000.

Required: Calculate the amount of the Brawn Inc.'s taxable income for the current year that would be allocated to each province and the United States. Any percentages used in your calculations should be rounded to one decimal place. Ignore any foreign tax implications.

SSP 12-6

Part I Tax with Reduced SBD

Jordu Inc. is a large CCPC. Gross business revenues for 2021 totalled \$3,460,000, with 28% of this amount generated in Ontario, 63% in British Columbia, and the remaining 9% coming from outside of Canada. The revenues were earned in a country where Jordu has a permanent establishment. Wages and salaries for this period totalled \$1,250,000, all of which were paid in British Columbia.

Taxable income for the 2021 taxation year was determined to be \$1,265,000, with \$130,000 attributable to foreign business income and \$1,135,000 attributable to Canadian active business income. Foreign income and profits tax totalled \$19,500. Jordu is associated with three other companies. The four companies have agreed to share the 2021 business limit equally. The combined taxable capital employed in Canada (TCEC) for Jordu and its associated companies is \$14,126,384 for 2021. For 2020, the corresponding figure is \$13,246,900.

Neither Jordu nor any of its associated companies have any adjusted aggregate investment income for 2020.

Assume that Jordu's foreign tax credit will be equal to the amount of foreign taxes paid.

Required: Calculate Jordu's minimum federal Part I tax payable for the year ending December 31, 2021.

SSP 12-7

Corporate Tax Payable—Simple

The Serendipity Shop Corp. sells art works on consignment in Winnipeg. The shares of Serendipity Shop Corp. are all owned by Elizabeth Montgomery, a Canadian residing in Winnipeg.

The Serendipity Shop Corp. has net income of \$240,000 for the year ending December 31, 2021. Net income is composed of \$220,000 in business income and \$20,000 in taxable dividends from various investments in Canadian public companies. None of the company's income qualifies for the M&P deduction.

In May 2021, the Serendipity Shop Corp. donated \$48,000 to the Canadian Indigenous Art Foundation, a registered Canadian charity. There are no carry forwards of donations or losses, and the corporation paid no dividends in the year.

Serendipity is associated with another corporation. The associated companies have agreed to share the business limit, with Serendipity's share being \$135,000. The combined TCEC of Serendipity and its associated corporation is less than \$10 million in both 2020 and 2021. The combined AAll of the two companies was \$27,000 in 2020.

Required: Determine taxable income and Part I federal tax payable for the Serendipity Shop Corp. for the year ending December 31, 2021.

SSP 12-8

Net and Taxable Income, Tax Payable

Borscan Inc.'s shares are publicly traded. None of its income is from manufacturing or processing. During the taxation year ending December 31, 2021, the condensed statement of

comprehensive income of Borscan Inc. was prepared in accordance with International Financial Reporting Standards (IFRS). In condensed form it is as follows:

Borscan Inc.
Condensed Statement of Comprehensive Income
(Pre-Tax Amounts)

Year Ending December 31, 2021

Revenues	\$2,800,000
Expenses (excluding taxes)	(1,550,000)
Operating income	\$1,250,000
Gain on expropriated property	25,000
Income before taxes	\$1,275,000

Other Information:

1. The expropriation of a building and the land it is situated on for total proceeds of \$625,000 resulted in the \$25,000 gain disclosed on the statement of comprehensive income. The building had a capital cost of \$500,000. The land on which the building is situated cost \$100,000. Since this was also the fair market value of the land at the time of the expropriation, \$100,000 of the proceeds is allocated to the land. As the company leases all of its other property, the building was the only property in class 1. The UCC balance of this class, prior to the disposition of the building, was \$350,000.
2. Amortization included in the accounting expenses amounts to \$255,000. Maximum available deductions for CCA amount to \$287,000.
3. Expenses include interest and penalties of \$500 resulting from a failure to file the previous year's tax return on time.
4. Revenues include taxable dividends from taxable Canadian corporations in the amount of \$25,000.
5. Expenses include a deduction for charitable donations in the amount of \$13,500.
6. The company has a 2019 non-capital loss balance of \$35,000 and a 2020 net capital loss balance of \$30,000.

Required:

- A. Calculate the minimum net income for Borscan Inc. for 2021.
- B. Calculate the minimum taxable income for Borscan Inc. for 2021. Indicate the amount and type of any carry overs that are available at the end of the year to be claimed in other years.
- C. Calculate the minimum federal Part I tax payable for Borscan Inc. for 2021.

SSP 12-9

Net and Taxable Income, Tax Payable

During its taxation year ending December 31, 2021, the condensed income statement of Industrial Tools Ltd. was prepared in accordance with International Financial Reporting Standards (IFRS). In condensed form it is as follows:

Industrial Tools Ltd.
Condensed Income Statement (Pre-Tax Amounts)

For The Year Ending December 31, 2021

Revenues	\$6,585,000
Expenses (excluding taxes)	(4,280,000)
Net income before taxes	\$2,305,000

Other Information:

1. The company's shares are publicly traded and none of its income is from M&P.
2. Revenues include an accounting gain of \$225,000, resulting from the sale of a building for \$1,150,000 in cash. The property had cost \$1,075,000. This was made up of \$200,000 for the land and \$875,000 for the building. It is the only property in class 1, and the UCC balance in this class prior to the sale was \$625,000. At the time of the sale, the FMV of the land was unchanged at \$200,000.
3. There is a 2019 net capital loss carry forward available of \$90,000.
4. Expenses included a deduction for charitable donations in the amount of \$28,000.
5. The expenses include interest and penalties of \$2,500, resulting from late filing last year's income tax return.
6. Expenses include a warranty reserve of \$20,000. This is the first year that the company has deducted such a reserve.
7. Revenues include taxable dividends from taxable Canadian corporations of \$42,000.
8. Amortization included in the accounting expenses amounts to \$478,000. Maximum available deductions for CCA amount to \$523,000.

Required:

- A. Calculate the minimum net income for Industrial Tools Ltd. for the year ending December 31, 2021.
- B. Calculate the minimum taxable income for Industrial Tools Ltd. for the year ending December 31, 2021. Indicate the amount and type of any loss carry overs that are available for use in subsequent years.
- C. Calculate the minimum federal Part I tax payable for Industrial Tools Ltd. for the year ending December 31, 2021.

Show all calculations, whether or not they are necessary to the final solution.

SSP 12-10

Comprehensive Corporate Tax Payable

For the year ending December 31, 2021, Mamora Ltd. had accounting income before taxes of \$1,115,050. Mamora is a CCPC throughout 2021. Other Information related to the company's 2021 taxation year is as follows:

1. The accounting income figure included a deduction for amortization expense of \$405,525.

2. On January 1, 2021, Mamora Ltd. had the following UCC balances:

Class 1	\$1,050,000
Class 8	1,460,000
Class 10	142,000
Class 13	175,000

The class 1 balance relates to a single building acquired at a cost of \$1,650,000. It is estimated that the cost of land included in this amount is \$350,000 with the remaining cost of \$1,300,000 attributable to the building. In June 2021, this building is sold for \$1,725,000, based on a value of \$375,000 for the land and \$1,350,000 for the building. For accounting purposes, the carrying value of the building was \$1,200,000, plus \$350,000 for the land. As a result of this sale, a gain of \$175,000 was included in the accounting income figure.

The old building is replaced on February 15, 2021, with a new building acquired at a cost of \$2,100,000, of which \$400,000 is attributable to the land and \$1,700,000 to the building. Ninety-five percent of the floor space of the building is used for M&P activity. An election was filed with the CRA to include the building in a separate class 1.

During 2021, class 8 properties are acquired at a cost of \$150,000. There are no class 8 dispositions for the year.

As the company has decided to lease all of its vehicles in the future, all of its class 10 properties are sold during the year. The total capital cost of the class 10 properties was \$285,000 and the proceeds of disposition amounted to \$122,000. No single property was sold for more than its capital cost. The carrying value of the class 10 properties for accounting purposes was \$185,000, resulting in a loss of \$63,000 being included as part of the accounting income.

The class 13 balance relates to a single lease that commenced on January 1, 2016. The lease has an initial term of six years, with an option to renew for four years. Expenditures on this leasehold were \$250,000 in 2016 and \$60,000 in 2020. There were no further expenditures in 2021. The write-off of these expenditures for accounting purposes is included in the amortization expense figure that was deducted in the determination of accounting income.

It is the policy of Mamora to deduct maximum CCA in each year.

- The accounting income figure included a gain on the sale of vacant land of \$75,000. This land had been acquired several years ago for \$620,000. While the company had intended to construct a new building on this site, they had concluded that their current operations did not justify this investment. Given this, the land was sold for \$695,000. The buyer provided a 2020 payment of \$295,000, with the balance due in four annual payments of \$100,000 each beginning on December 31, 2022.
- The company spent \$53,000 during the year on landscaping for its new building. While this expenditure was treated as an asset for accounting purposes, Mamora did not amortize the balance as it believed the work had an unlimited life.
- Using the formula found in the ITR, 88% percent of Mamora's income is considered to

have been earned in a province.

6. Mamora's accounting income includes foreign business income of \$15,300. This amount is net of withholdings in the foreign jurisdiction in the amount of \$2,700.
7. As the company expects to issue more shares during 2022, it made a number of amendments to its articles of incorporation. The legal costs for these changes were \$21,000. They have been deducted in the determination of accounting income.
8. Other amounts deducted in the determination of accounting income are as follows:

Bond discount amortization	\$ 4,600
Donations to registered charities	12,500
Interest on late income tax instalments	1,400
Interest on late municipal tax payments	625

9. Accounting income was reduced by \$42,000 for the cost of business meals and entertainment. In addition, a deduction of \$23,000 was made for the cost of a membership in a golf club for the president of the company. She uses the club only for entertaining business clients.
10. Mamora had a 2018 net capital loss balance of \$210,000, as well as a 2019 non-capital loss balance of \$95,000.
11. For 2021, Mamora has active business income in Canada of \$976,380, \$425,000 of which results from M&P activity.
12. Mamora Ltd. is associated with several other CCPCs. Mamora's share of the group's annual business limit for 2021 is \$175,000. The combined taxable capital employed in Canada of the group of associated companies is less than \$10 million in both 2020 and 2021.
13. The combined adjusted aggregate investment income of the group of associated companies is equal to \$39,800 for 2020.
14. Mamora received \$22,000 in taxable dividends from taxable Canadian corporations in 2021.

Required:

- A. Calculate the minimum net income for Mamora Ltd. for 2021. In addition, calculate the UCC balance on January 1, 2022, for each CCA class. Ignore the possibility of using the replacement property election.
- B. Calculate the minimum taxable income for Mamora Ltd. For 2021. Indicate the amount and type of any carry over balances that are available to be claimed in other years.
- C. Calculate the minimum federal Part I tax payable for Mamora Ltd. for 2021. As the corporation operates in provinces that have a reduced tax rate for M&P activity, a separate calculation of the federal M&P deduction is required. Assume that the foreign tax credit for foreign business income is equal to the foreign taxes withheld.

Chapter 13 Self Study Problems

Solutions are available in the Study Guide.

SSP 13-1

Integration Example

Assume the following with respect to the shareholder of a CCPC:

- The corporation's business income for the year is \$50,000.
- Any taxable dividends paid are non-eligible dividends.
- The individual's marginal federal tax rate is 33% and his marginal provincial tax rate is 16%.
- The provincial dividend tax credit is equal to 4/13 of the gross up.
- The combined federal and provincial corporate tax rate is 17%.

Required: Indicate, using these assumptions, whether integration is working perfectly. If your answer is no, briefly explain why this is the case. Also discuss whether there is a possible deferral opportunity from incorporating even though integration may not be working properly.

SSP 13-2

Dividend Refund

Kalec Ltd. is a CCPC with a taxation year that ends on December 31. On January 1, 2021, the balance in the eligible RDTOH was \$201,250 [(38 1/3%) (\$525,000)] and the balance in the non-eligible RDTOH was \$143,750 [(38-1/3%) (\$375,000)]. No taxable dividends were paid in 2020.

During 2021, there were no additions to either RDTOH account. During 2021, the corporation paid taxable dividends of \$900,000, of which \$300,000 were designated as eligible. The GRIP balance was large enough to support this designation.

Determine the amount of the dividend refund on the payment of (1) the eligible dividends and (2) the non-eligible dividends.

SSP 13-3

Refundable Dividend Tax on Hand

Mr. Stevens, a Canadian resident, owns 100% of the shares of Stevens Holdings Inc. (SHI), which in turn owns 100% of Fancy Operating Ltd. (FOL). Both SHI and FOL have a December 31 year end. Neither corporation paid any taxable dividends in 2020. On January 1, 2021, neither corporation had a GRIP balance.

The following information pertains to the year ending December 31, 2021:

Fancy Operating Ltd. (FOL)

- The balance in the non-eligible RDTOH at January 1, 2021, was \$2,000. The balance in the eligible RDTOH on this date was nil.
- The corporation earned active business income of \$80,000 and Canadian interest income of \$7,000 on long-term corporate bonds.

- The corporation paid taxable dividends to SHI of \$75,000. None of these dividends were designated as eligible.

Stevens Holdings Inc. (SHI)

This corporation:

- received a taxable dividend from FOL of \$75,000
- received eligible dividends on Royal Bank common shares of \$8,000
- earned Canadian interest income of \$12,000 on long-term corporate bonds
- realized a taxable capital gain of \$23,625
- paid a taxable dividend of \$50,000 to Mr. Stevens
- had a January 1, 2021, balance in its non-eligible RDTOH of \$10,000. The balance in the eligible RDTOH was nil

It is the policy of SHI to designate dividends as eligible only to the extent that a dividend refund will be available on their payment.

Assume that, for both corporations, the refundable portion of Part I tax is equal to 30 2/3% of aggregate investment income.

Required:

- A. Determine the amount of refundable taxes paid by FOL during 2021, the December 31, 2021, eligible RDTOH and non-eligible RDTOH for FOL, and the dividend refund that will be received by FOL for 2021.
- B. Determine the amount of refundable taxes paid by SHI during 2021, and the December 31, 2021, eligible RDTOH and non-eligible RDTOH for the corporation.
- C. Calculate the 2021 dividend refund for SHI.

SSP 13-4

Part I and Part IV Refundable Taxes

Insal Ltd. is a CCPC. with a December 31 year end. The following information relates to the 2021 taxation year:

1. During 2021, Insal Ltd. has taxable income of \$123,400. Assume that Part I tax payable for the year was correctly calculated to be \$23,960. This amount has been reduced by a small business deduction of \$8,550. The taxable income figure does not include any foreign source income and no net capital losses were deducted during 2021.
2. At the beginning of 2021, Insal's non-eligible RDTOH balance was \$4,150. The eligible RDTOH balance on this date was nil. There was no GRIP balance on this date.
3. Insal Ltd. owns 45% of the voting shares of Dorne Inc., another CCPC with a December 31 year end. During 2021, Dorne Inc. paid taxable dividends of \$25,200, none of which were designated as eligible. However, as a consequence of paying these dividends, Dorne Inc. received a dividend refund of \$8,400, all of which was attributable to its non-eligible RDTOH.
4. Other income that was reported by Insal Ltd. consisted of the following amounts:

Taxable capital gain on sale of land	\$12,300
Eligible dividends from public company preferred shares	6,200
Rental income from residential properties	4,200

5. Insal Ltd. paid taxable dividends of \$18,250 during the year. It is the corporation's policy to only designate dividends as eligible to the extent that a refund is available on their payment.

Required:

- Determine the amount of Part IV tax payable by Insal for 2021.
- Determine Insal's Part I refundable tax for 2021.
- Determine Insal's December 31, 2021, eligible and non-eligible RDTOH.
- Determine the amount of any dividend refund available to Insal as a result of paying the \$18,250 in taxable dividends during 2021. Show the separate calculations for each RDTOH.

SSP 13-5**Part I and Part IV Refundable Taxes, GRIP**

Vader Ltd. is a CCPC involved in the distribution of domestically produced laser products. For the taxation year ending December 31, 2021, its net income was made up of the following components:

Active business income	\$ 216,300
Dividends from Canadian corporations:	
Wholly owned subsidiary (all non-eligible)	108,000
Portfolio investments (all eligible)	56,000
Interest on government bonds	36,300
Taxable capital gains	57,300
Net income	<u>\$473,900</u>

On December 31, 2020, Vader Ltd., has a GRIP balance of \$59,000 and a nil balance in both the eligible and non-eligible RDTOH. During 2020, Vader Ltd. paid no taxable dividends.

For 2020, the corporation's adjusted aggregate investment income was \$33,000 and its taxable capital employed in Canada was \$2 million.

The dividends paid to Vader Ltd. by its wholly owned subsidiary in 2021 did not entitle the subsidiary to any dividend refund. The wholly owned subsidiary is allocated \$200,000 of the small business limit. The remainder of \$300,000 is allocated to Vader Ltd.

On October 1, 2021, Vader Ltd. paid taxable dividends to its shareholders in the amount of \$32,400. The corporation would like to pay the maximum amount of eligible dividends on which a dividend refund would be available.

Required: Show all of the calculations used to provide the following required information, including those for which the result is nil.

For Vader Ltd.'s 2021 taxation year, calculate the following:

- A. The Part I tax payable
- B. The refundable portion of Part I tax
- C. The Part IV tax payable
- D. The balance in the GRIP account on December 31, 2021
- E. The balance in the eligible and non-eligible RDTOH accounts on December 31, 2021
- F. The amount of any dividend refunds resulting from (1) the payment of eligible dividends and (2) the payment of non-eligible dividends
- G. Federal tax payable (net of any dividend refund)
- H. The balance in the eligible RDTOH and non-eligible RDTOH accounts on January 1, 2022

SSP 13-6 Tax Payable with SBD, ART, FTC, and GRR

Sinzer Ltd. is a CCPC. All of its shares are owned by Ebenezer Sinzer. Its business operations consist of sales and consulting with respect to interior design and decoration, and its head office is in Windsor, Ontario. For the taxation year ending December 31, 2021, taxable income for Sinzer Ltd. was calculated as follows:

Income from design consulting	\$103,000
Income from sales	386,000
Interest income from Canadian sources (Note 1)	48,300
Dividends from taxable Canadian corporations (Note 2)	88,100
Foreign investment income (Note 3)	55,000
Taxable capital gains on sale of shares	24,500
Net Income	\$704,900
Dividends from taxable Canadian corporations	(88,100)
Donations to a registered charity	(24,600)
Non-capital loss deducted	(76,400)
Net capital loss deducted	(12,300)
Taxable income	\$503,500

Note 1 The Canadian interest is from the following sources:

Interest on loan to a majority owned subsidiary (the subsidiary has no active business income)	\$43,250
Term deposit and bank interest arising from seasonal investment of excess cash from operations	5,050
Total	\$48,300

Note 2 The dividends from taxable Canadian corporations consisted of the following:

Eligible portfolio dividends	\$19,600
Non-eligible dividends from 75% owned subsidiary (total dividend refund of \$12,750 to the subsidiary)	68,500
Total	\$88,100

Note 3 The \$55,000 is before withholding of \$8,250 in foreign taxes. Assume that the foreign non-business income tax credit in the calculation of Part I tax payable is equal to \$8,250.

Other Information:

1. Sinzer was allocated \$200,000 of the business limit for 2021. Assume that this is the amount that is eligible for the small business deduction.
2. The balance in the non-eligible RDTOH December 31, 2020, was \$23,500, and the dividend refund for 2020 was \$9,600. The balance in the eligible RDTOH on that date was nil.
3. The balance in the corporation's GRIP on December 31, 2020, was nil.
4. At the end of 2020, the combined associated corporations adjusted aggregate investment income was \$41,000 and taxable capital employed in Canada was \$3 million.
5. During 2021, Sinzer declared four quarterly taxable dividends in the amount of \$28,000 each for a total of \$112,000. The first of these dividends was paid in March 2021, the second in June 2021, the third in October 2021, and the fourth was paid in January 2022. A \$25,000 taxable dividend declared in December 2020 was paid in January 2021.
6. It is the policy of the corporation to maximize the amount of dividends designated as eligible.
7. Using the formula found in the ITR, it has been determined that 72.95% of Sinzer's taxable income is considered to have been earned in the year in a province. A total of \$34,300 was paid in U.S. income and profits taxes on the foreign business income earned in the U.S. Assume that the foreign business income tax credit in the calculation of Part I tax payable is equal to \$34,300.

Required: Show all of the calculations used to provide the following required information, including those for which the result is nil.

For Sinzer Ltd.'s 2021 taxation year, calculate the following items:

- A. The Part I tax payable
- B. The refundable portion of Part I tax payable
- C. The Part IV tax payable
- D. The balance in the GRIP account on December 31, 2021
- E. The balance in the eligible and non-eligible RDTOH accounts on December 31, 2021
- F. The amount of any dividend refunds resulting from (1) the payment of eligible dividends and (2) the payment of non-eligible dividends
- G. Federal tax payable (net of any dividend refund)

H. What advice would you give Ebenezer Sinzer about Sinzer Ltd.'s dividend policy?

SSP 13-7

Tax Payable with SBD, ART, and GRR

Acme Imports Ltd. is a CCPC. The company carries on business importing a variety of consumer products for distribution to wholesalers in Canada. The before income taxes balance sheet and income statement of Acme Imports Ltd. for the year ending December 31, 2021, are as follows:

Acme Imports Ltd.
Balance Sheet before Income Taxes
As of December 31, 2021

Assets		
Accounts receivable		\$1,080,000
Inventories		1,065,000
Investment in Sarco Ltd.		695,000
Land		385,000
Equipment—Cost	\$840,000	
Accumulated amortization	(414,000)	426,000
Intangible assets		183,000
Total assets		\$3,834,000

Equities		
Bank overdraft		\$ 87,000
Note payable to bank		306,000
Accounts payable		682,000
Mortgage on land		244,000
Future income tax liability		53,000
Common stock—No par		32,000
Retained earnings		2,430,000
Total equities		\$3,834,000

Acme Imports Ltd.
Income Statement before Income Taxes
Year Ending December 31, 2021

Sales	\$ 7,387,700
Dividend income	24,000
Interest revenue	10,000
Gain on sale of equipment	57,000
Total revenues	\$ 7,478,700
Cost of goods sold	\$6,071,400
Rent	118,000
Selling expenses	283,000
Wages and salaries	266,500
Employee benefits	32,000
Office expenses	158,000
Fees for professional services	43,000
Interest	47,000
Promotional expenses	99,000

Amortization expense	29,500
Charitable donations	25,000
Vehicle costs	74,000
<u>Total expenses not including income taxes</u>	<u>\$ 7,246,400</u>
<u>Income before taxes</u>	<u>\$ 232,300</u>

Other Information: The following additional information is available with respect to the 2021 operations of Acme Imports Ltd.:

1. The intangible assets consist of an amount paid for a list of potential customers. This list was acquired during December 2021 from a competitor who had ceased doing business. The intangible asset has been tested for impairment, but none was found. As a consequence, no write-down is included in total expenses.
2. On January 1, 2021, the equipment, which is all in class 8, had a UCC of \$256,000. The January 1, 2021, UCC balance for class 14.1 was nil.
3. The gain on the sale of equipment resulted from selling display fixtures and equipment with an original cost of \$62,000 and a carrying value of \$27,500, for cash proceeds of \$84,500.
4. A small group of new shares were issued during the year. The cost of printing these shares was \$950 and was included in office expenses. In addition, \$7,000 of the professional fees paid were for legal and other costs associated with obtaining the supplementary letters patent required to issue these shares.
5. The interest income came from corporate bonds that had been held for four years and sold during the year. The bonds were purchased and sold at their maturity value.
6. Included in promotional expenses is a \$2,800 membership fee to a local golf and country club. In addition, there were charges at this club for business meals and entertainment totaling \$6,720.
7. The company provides cars for the principal shareholder and the manager of the company. Both of these individuals are considered to be employees of the company. Included in vehicle costs are lease payments of \$500 per month, for 12 months, for each car, and a total of \$11,000 in operating costs associated with providing these cars. While these individuals use the cars for some business purposes, it is estimated that over 80% of their usage is personal.
8. The dividend income of \$24,000 was Acme's share of a non-eligible dividend paid by Sarco Ltd., a 60% owned subsidiary company. As a result of declaring the dividend, Sarco received a total dividend refund of \$5,000 from its non-eligible RDTOH. None of the business limit for the small business deduction was allocated to Sarco and as a result Acme's business limit for 2021 is \$500,000.
9. For 2020 Acme and Sarco's combined adjusted aggregate investment income was \$110,000 and their combined taxable capital employed in Canada was \$4,500,000.
10. On January 1, 2021, Acme Imports Ltd. had a nil balance in both its eligible RDTOH and its non-eligible RDTOH. Also on January 1, 2021, Acme's GRIP was nil.
11. Acme Imports Ltd. did not declare or pay any taxable dividends during 2021.
12. During 2021, the company decided that it had grown to the point where additional space was needed and, rather than continue to rent space, it has decided to acquire its own

premises. It paid a fee of \$3,500 (included in fees for professional services) to a site consultant and, on the basis of his recommendation, acquired land at a cost of \$385,000. The site was purchased on April 1, 2021, and construction of the new facility is to begin early in 2022. The company's other expenses included \$12,300 in interest on the mortgage used to finance this land.

Required: Show all of the calculations used to provide the following required information, including those for which the result is nil.

- A. Determine Acme Imports Ltd.'s minimum net income and taxable income for the year ending December 31, 2021.
- B. Determine Acme Imports Ltd.'s active business income for the year ending December 31, 2021.
- C. Determine Acme Imports Ltd.'s minimum federal tax payable for the year ending December 31, 2021. This should include both Part I and Part IV Tax Payable, net of any dividend refund.
- D. Determine the December 31, 2021, balances in Acme Imports Ltd.'s eligible RDTOH, non-eligible RDTOH, and GRIP.

SSP 13-8 Tax Payable with SBD, ART, FTC, GRR, and GRIP

Brasco Distributors is a CCPC. Its primary business is the distribution of a variety of consumer products to retailers throughout Canada. Its fiscal year ends on December 31.

While its current operations are providing a reasonable rate of return on invested capital, losses have been experienced in previous years. As a result, at the beginning of the year ending December 31, 2021, it has available a 2019 non-capital loss balance of \$25,800 and a 2019 net capital loss balance of \$64,500.

Other Information:

1. During the year ending December 31, 2021, the company made donations of \$11,900 to registered Canadian charities.
2. Its net taxable capital gains for 2021 amounted to \$36,000.
3. The company's 2021 active business income is \$171,000.
4. On January 1, 2021, the balance in the company's eligible RDTOH balance was \$7,000. The non-eligible RDTOH on that date was nil.
5. On January 1, 2021, Brasco had a GRIP balance of \$126,000.
6. During 2021, the total taxable dividends declared and paid to shareholders of the company amounted to \$39,000. It is the policy of Brasco to designate dividends as eligible only to the extent that a refund is available on their payment. No taxable dividends were paid in 2020.
7. During 2021, the company received \$2,200 in interest from long-term Canadian bonds. In addition, on common shares that represent portfolio investments in taxable Canadian companies, the company received eligible dividends of \$15,800. The company received foreign source investment income of \$3,825. This was the net amount, after the withholding of \$675 in income and profits taxes by the foreign jurisdiction.

8. Brasco owns 60% of the outstanding voting shares of Masco, a Canadian subsidiary. During the year, Brasco received \$37,800 in non-eligible dividends from Masco. The total 2021 taxable dividends paid by the subsidiary amounted to \$63,000 and, as a result of paying these dividends, Masco claimed a dividend refund of \$24,150, all of which was drawn from its non-eligible RDTOH. Because it is an associated company, Brasco must share the annual limit on its small business deduction with Masco. Brasco's share of the business limit for 2021 is \$125,000.
9. For 2020, the adjusted aggregate investment income of Brasco and its subsidiary was \$34,500 and the combined taxable capital employed in Canada was \$3,650,000.

Required: Show all of the calculations used to provide the following required information, including those for which the result is nil.

- A. Calculate Brasco's minimum net income and taxable income for the year ending December 31, 2021.
- B. Calculate Brasco's Part I tax payable for the year ending December 31, 2021. For the purposes of this calculation, assume that the foreign non-business income tax credit is equal to the amount withheld.
- C. Calculate Brasco's refundable Part I tax payable for 2021.
- D. Calculate Brasco's Part IV tax payable for 2021.
- E. Determine Brasco's GRIP balance at December 31, 2021.
- F. Determine the December 31, 2021, balances in Brasco's eligible RDTOH and non-eligible RDTOH.
- G. Determine Brasco's dividend refund for 2021.
- H. Do the complete calculation required to determine the foreign non-business income tax credit that will be used in determining the small business deduction, as well as the complete calculation that will be used to determine the foreign non-business income tax credit that will be deducted.

Chapter 14 Self-Study Problems

Solutions are available in the Study Guide.

SSP 14-1 Acquisition of Control Rules—Losses

Tasty Bread Inc. opened a large bakery operation on January 1, 2019. At this time, the company's taxation year end is December 31. In addition to baking bread, the company was in charge of the wholesale distribution of its products and operated a large retail outlet on the bakery premises.

The owners of the corporation had little experience in any aspect of baking or selling bread and, as a consequence, during the first two years they experienced the following losses:

Type of Loss	2019	2020
Non-capital losses	\$63,500	\$78,500
Net capital losses	34,000	42,500

At the beginning of 2021, the owners did not see any real hope for improved results under their own management and they began looking for new investors with more experience in the bakery industry. Their efforts met with success when, on April 1, 2021, Dough Products Ltd. acquired 72% of the outstanding shares of Tasty Bread Inc. Dough Products is a large Canadian public company with a December 31 year end and many years of successful operation in the industry. It is the intent of the new owner to inject additional capital and management expertise with a view to making Tasty's operations profitable within two years.

As this acquisition of control will result in a deemed year end, Tasty prepared an income statement for the period January 1, 2021, through March 31, 2021. This three-month income statement showed an additional business loss of \$23,000 for the period, but no further capital losses.

On March 31, 2021, the values of the company's property were as follows:

Asset	Cost	UCC	FMV
Temporary investments	\$ 53,000	N/A	\$ 23,000
Accounts receivable	45,000	N/A	33,000
Land	275,000	N/A	420,000
Building	285,000	\$270,000	320,000
Fixtures and equipment	120,000	95,000	90,000
Vehicles	110,000	80,000	87,000

Shortly after taking over Tasty Bread Inc., Dough Products Ltd. decided that some of the extra space in Tasty's facilities could be used for manufacturing illuminated glass figurines. Tasty's income (loss) from the two separate businesses for the period April 1, 2021, through December 31, 2021, was as follows:

Business	Income (Loss)
Figurines	\$123,000
Bread operations	(45,000)

For 2022, the income (loss) figures for the two separate businesses were as follows:

Business	Income (Loss)
Figurines	(\$ 40,000)
Bread operations	211,000

Required:

- If Tasty Bread Inc. makes all possible elections to minimize the net capital and non-capital loss balances, determine the amount of the non-capital loss balance that will be carried forward, subject to restriction, after the acquisition of control by Dough Products Ltd., and the amount of any net capital loss balance that will be tainted.
- Indicate the maximum amount of the non-capital loss carry forward that can be used during the period April 1 through December 31, 2021.
- Indicate the maximum amount of non-capital losses that can be claimed in 2022.

SSP 14-2 Acquisition of Control Rules—Losses

On May 1, 2021, Ontario Lawn Care Ltd. (OLC), which provides gardening and lawn services for the southern Ontario market, purchased, from an unrelated person, all of the shares of Lawn Fertilizer Inc. (LF), a company in the business of manufacturing lawn fertilizers. LF has a December 31 year end.

A highly competitive fertilizer market has resulted in the following business losses for LF:

Year	Non-Capital Loss	Net Capital Loss
2019	\$180,000	\$65,000
2020	140,000	Nil

It is estimated that business losses of \$125,000 for the 2021 year will be expected. This is made up of an actual loss of \$55,000 up to April 30, 2021, and an estimated loss of \$70,000 for the remainder of the year.

Relevant values for LF's properties on May 1, 2021, were as follows:

Asset	Cost	UCC	FMV
Inventory	\$100,000	N/A	\$105,000
Land	450,000	N/A	925,000
Class 1—Building	675,000	\$515,000	650,000
Class 8—Furniture	25,000	10,000	15,000
Class 53—Manufacturing equipment	500,000	375,000	285,000

Required:

- Describe the general income tax implications resulting from the acquisition of control.
- Indicate the elections that could be made to increase income during the short fiscal period ending April 30, 2021, for the purposes of using loss balances.
- Assume that LF is confident of having sufficient business income in the future to absorb any non-capital loss balances restricted by the acquisition of control. Advise the company as to any elections that should be made and determine the amount and type of any loss carry forwards that will be available to be claimed in subsequent taxation years.

- D. Assume that LF is not confident of having sufficient business income in the future and would like to minimize any non-capital loss balances restricted by the acquisition of control. Advise the company as to any elections that should be made and determine the amount and type of any loss balances that will be available in subsequent taxation years.

SSP 14-3

Associated Companies

The following situations are independent of each other. All the corporations involved are CCPCs and have only one authorized class of shares.

- A. John Fleming and Eric Flame are married, and their spouses are sisters. John Fleming owns 100% of the outstanding common shares of Fleming Ltd. and 32% of the outstanding common shares of Lartch Inc. Eric Flame owns 100% of the outstanding common shares of Flame Ltd. and 28% of the outstanding common shares of Lartch Inc. The remaining common shares of Lartch Inc. are owned by unrelated persons.
- B. Mr. Cuso owns 80% of the outstanding common shares of Male Ltd. The remaining 20% of the Male Ltd. shares are owned by his spouse, Mrs. Cuso. Mrs. Cuso owns 82% of the outstanding common shares of Female Inc. Her spouse owns the remaining 18% of the shares in this company.
- C. Ms. Jones, Mrs. Kelly, and Miss Lange are unrelated individuals. Ms. Jones owns 50% of the outstanding common shares of Alliance Ltd. and 25% of the outstanding voting shares of Breaker Inc. Mrs. Kelly does not own any of the Alliance Ltd. shares but owns 50% of Breaker Inc.'s outstanding voting shares. Miss Lange owns 50% of the outstanding common shares of Alliance Ltd. and 25% of the outstanding voting shares of Breaker Inc.
- D. Mr. Martin and Mr. Oakley each own 50% of the shares of Oakley Ltd. In addition, they each own 50% of the shares of Martin Inc. Mr. Martin and Mr. Oakley are not related.
- E. Lily Fung owns 100% of the shares of 123LF Inc. Her husband, James Fung, owns 100% of the shares of 456JF Inc.

Required: For each of the preceding situations, indicate whether the corporations are associated and explain your conclusion with reference to the ITA. To assist you in answering this question, we have provided you with the content of ITA 256(1).

ITA 256(1) Associated corporations—For the purposes of this Act, one corporation is associated with another in a taxation year if, at any time in the year,

- A. one of the corporations controlled, directly or indirectly in any manner whatever, the other;
- B. both of the corporations were controlled, directly or indirectly in any manner whatever, by the same person or group of persons;
- C. each of the corporations was controlled, directly or indirectly in any manner whatever, by a person and the person who so controlled one of the corporations was related to the person who so controlled the other, and either of those persons owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof;
- D. one of the corporations was controlled, directly or indirectly in any manner whatever, by a person and that person was related to each member of a group of persons that so controlled the other corporation, and that person owned, in respect of the other

corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof; or

- E. each of the corporations was controlled, directly or indirectly in any manner whatever, by a related group and each of the members of one of the related groups was related to all of the members of the other related group, and one or more persons who were members of both related groups, either alone or together, owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof.

SSP 14-4

Associated Companies

Each of the following is an independent case involving the ownership of voting shares of CCPCs. All the corporations have taxation years that end on December 31 and have only one authorized class of shares.

1. Mr. Jones owns 35% of the shares of Jones Ltd. and 20% of the shares of Twitty Inc. Mr. Twitty owns 20% of the shares of Jones Ltd. and 40% of the shares of Twitty Inc. Mr. Jones and Mr. Twitty are not related.
2. Ms. Wynette owns 60% of the shares of Wynette Enterprises Ltd. and 30% of the shares of Lynn Inc. The remaining 70% of the shares of Lynn Inc. are held by Ms. Wynette's sister and her spouse.
3. Mr. Travis, Mr. Jennings, and Mr. Cash, three unrelated individuals, each hold one-third of the shares of Cowboys Ltd. In addition, Mr. Travis and Mr. Cash each hold 50% of the shares of Horses Inc.
4. Mr. Nelson owns 80% of the shares of Willie's Hits Ltd. and 30% of the shares of Randy's Boots Inc. Willie's Hits Ltd. owns 20% of the shares of Hill Inc. Randy's Boots Inc. owns 80% of the shares of Hill Inc.
5. Ms. Parton owns 90% of the shares of Alpha Company and her spouse owns 100% of the shares of Centra Company. Ms. Parton and her spouse each own 40% of the shares of Beta Company.
6. Ms. Gale owns 90% of the shares of Kristal Enterprises Ltd. and 10% of the shares of Norton Music Inc. Her 12-year-old son owns 30% of the shares of Norton Music Inc., and Ms. Gale holds an option to acquire shares in Norton Music Inc. from an unrelated shareholder that if exercised would result in an increase in her shareholding of 20% of the shares.

Required: For each of the six cases, determine whether the corporations are associated. Support your conclusions with references to specific provisions of ITA 256. To assist you in answering this question, we have provided you with the content of ITA 256(1).

ITA 256(1) Associated corporations — For the purposes of this Act, one corporation is associated with another in a taxation year if, at any time in the year,

- A. one of the corporations controlled, directly or indirectly in any manner whatever, the other;
- B. both of the corporations were controlled, directly or indirectly in any manner whatever, by the same person or group of persons;
- C. each of the corporations was controlled, directly or indirectly in any manner whatever, by a person and the person who so controlled one of the corporations was related to the

person who so controlled the other, and either of those persons owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof;

- D. one of the corporations was controlled, directly or indirectly in any manner whatever, by a person and that person was related to each member of a group of persons that so controlled the other corporation, and that person owned, in respect of the other corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof; or
- E. each of the corporations was controlled, directly or indirectly in any manner whatever, by a related group and each of the members of one of the related groups was related to all of the members of the other related group, and one or more persons who were members of both related groups, either alone or together, owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof.

SSP 14-5

Investment Tax Credits

The following three independent cases involve the income tax consequences of incurring expenditures that are eligible for investment tax credits.

Case A

Since its incorporation, Luxor Ltd. has been a CCPC. Luxor's taxable income was \$756,000 for its taxation year ending December 31, 2020, and \$812,000 for its taxation year ending December 31, 2021.

Its taxable capital employed in Canada was \$11,500,000 for 2020 and \$12,200,000 for 2021.

Required: Determine Luxor's SRED expenditure limit for the 2021 taxation year.

Case B

Gargle Search Engine (GSE) has been a CCPC since its incorporation. GSE's taxable income in 2020 was \$12,000 and \$6,000 for 2021. The company has no tax payable for the taxation year ending December 31, 2021, or for any of the three preceding years.

Its taxable capital employed in Canada is \$12,300,000 in 2020 and \$14,600,000 in 2021.

During 2021, the company incurred a number of expenditures that qualify for investment tax credits:

- \$86,000 for qualified property in the Atlantic provinces.
- \$3,200,000 in current expenditures for SRED.

Required: Determine the amount of any refund that GSE will be entitled to as a result of these investment tax credits and any available carry forwards. Include in your answer any other related income tax consequences.

Case C

In 2020, Bow Inc. pays eligible salaries to 10 eligible apprentices. The total amount is \$250,000, with five apprentices paid \$15,000 each and five apprentices paid \$35,000 each. In addition, on December 10, 2020, Bow Inc. acquires \$800,000 in class 10 depreciable property on which a 10% investment tax credit is available. Assume that the investment tax credits available will be

deducted against tax payable in the year they are earned.

Required: Describe the 2020 and 2021 income tax consequences associated with the expenditures and claiming the related investment tax credits. Include in your solution the CCA for 2020 and 2021 for Case C.

SSP 14-6

Capital Dividend Account

Nardin Inc. was incorporated in 2005. It has always been a CCPC with a December 31 year end. Between its incorporation date and December 31, 2021, the following transactions involve the company's capital dividend account:

1. In 2010, the company sold capital property with an ACB of \$225,000 for \$343,500.
2. In 2011, the company received life insurance proceeds, net of the adjusted cost basis of the policy, in the amount of \$162,000.
3. In 2013, the company sold non-depreciable capital property with an ACB of \$220,000 for \$150,000.
4. During 2015, the company received a capital dividend of \$26,000.
5. During 2019, the company sold two non-depreciable capital properties. The first with an ACB of \$50,000 was sold for \$80,000 and the second with an ACB of \$100,000 was sold for \$45,000.
6. During each of 2019, 2020, and 2021, the company paid an ITA 83(2) capital dividend of \$45,000. The appropriate election was made in each year.

Required: Determine the balance in the company's capital dividend account as of December 31, 2021.

SSP 14-7

Capital Dividend Account

Carson Ltd. was incorporated in 2008 and since its inception it has been a CCPC. Between the date of its incorporation and December 31, 2021, it had the following transactions that relate to the company's capital dividend account:

- In 2010, the company received life insurance proceeds, net of the adjusted cost basis of the policy, in the amount of \$186,000.
- In 2012, the company received a capital dividend of \$26,300.
- In 2017, the company paid a capital dividend of \$45,200. The required election was made.
- In 2018, the company sold capital property with an ACB of \$184,300 for \$226,100.
- In 2020, the company sold two parcels of land. The first parcel of land, which had an ACB of \$48,600, was sold for \$93,400. The second parcel of land, which had an ACB of \$112,600, was sold for \$108,300.
- In 2021, the company paid a capital dividend of \$16,400. The required election was made.

Required: Determine the balance in the company's capital dividend account as of December 31,

2021.

SSP 14-8

Corporate Surplus Distributions

Required: Indicate the income tax consequences to the relevant shareholders of the transaction(s) described in each of the following four independent cases, including identifying the applicable IT 84 deemed dividend provision. Tax consequences include the increase or decrease in the individual shareholder's net and taxable income, any change in the ACB and PUC of any shares that are still outstanding after the described transaction(s), and any federal dividend tax credits. Assume that any dividends will be non-eligible.

Case 1

John Farnsworth owns all of the outstanding shares of John's Jeans (JJ), a CCPC. His shares have a PUC of \$323,000 and an adjusted cost base of \$462,000. The board of directors agrees to make a corporate distribution that will include a reduction of legal capital and therefore PUC. The distribution is \$260,000. The company reduced the PUC of its shares by \$163,000 as a result of the distribution. This return of PUC does not relate to the reorganization of the company's business.

Case 2

Technic Inc., a CCPC, was incorporated several years ago and, at that time, issued 250,000 common shares at a price of \$20 per share to one individual. Several years later, all of these shares were acquired from the original shareholder by Ms. Chawla who paid \$16.80 per share. The following year, the company redeemed one-half of Ms. Chawla's shares for \$20.80 per share, a total of \$2,600,000. The shares were not acquired or cancelled by the issuing corporation as a result of the reorganization of its business.

Case 3

At the beginning of the current year, Marston Ltd. has 233,000 shares outstanding. These shares were originally issued at \$22.50 per share. Sue Marston acquired 23,300, or 10%, of these shares at the time of their original issue.

One of the company's creditors has agreed to accept 42,000 new shares of Marston Ltd. as settlement of debt. The current amount owing on the debt is \$900,000. At this time, the shares are trading at \$24.10 per share.

Shortly after this debt settlement, Sue Marston sells her shares to an arm's-length person for \$24.85 per share.

Case 4

After liquidating one of its divisions a corporation has additional cash of \$1,175,000, all of which is distributed to the corporation's only shareholder. The sole shareholder has owned the only class of authorized shares for more than five years. The distribution will result in 40% of the shares being cancelled.

The PUC of the class of shares is \$800,000 and the total ACB is \$1,450,000. The balance in the company's capital dividend account is \$1,000,000, and the company makes the appropriate election to have the deemed dividend on the distribution treated as a capital dividend under ITA 83(2).

Chapter 15 Self-Study Problems

Solutions are available in the Study Guide.

SSP 15-1

Example of Integration

Your client, Keith Slater, is contemplating the creation of Slater Ltd. He would be the sole shareholder and he plans to incorporate his accounting business and investment portfolio. All of the after-tax corporate income would be paid out to him in dividends to finance his passion for art collecting. He has annual pension and RRIF income of over \$250,000, placing him in the maximum federal tax bracket of 33%. This income is sufficient to fully use all of his available tax credits.

Having taken income tax courses in the distant past, he vaguely remembers that something called integration plays a role in whether a corporation is tax advantageous or not. After some discussion and research, you compile the following estimated income amounts and tax rates:

Taxable income of accounting business (active business income)	\$80,000
Eligible portfolio dividends	96,000
Federal corporate tax rate after federal abatement	28%
Federal small business deduction	19%
General rate reduction	13%
Provincial corporate tax rate—CCPC rate	2%
Marginal federal personal tax rate	33%
Marginal provincial personal tax rate	18%
Provincial dividend tax credits on:	
Eligible dividends	5/11 of dividend gross up
Non-eligible dividends	4/13 of dividend gross up

Required:

- A. Briefly summarize the concept of integration.
- B. Assume no corporation is used and that the additional income is received directly. Calculate Mr. Slater's personal tax payable, showing separately the tax payable on the active business income and the dividends.
- C. Assume that the business and investments are incorporated with the additional income and dividends received by Slater Ltd. Calculate corporate tax payable, after-tax corporate income available for distribution, and personal income taxes that would be payable on the distribution by Mr. Slater. Your calculations should show separately the tax payable on the active business income and any eligible or non-eligible dividends.
- D. Compare the tax payable with and without the use of Slater Ltd. and explain why the tax payable amounts are different.

SSP 15-2 Advantages and Disadvantages of Incorporation

Mr. Gerald Copley is in his late 40s. He is married and has two children who are attending university. For over 10 years he has been carrying on a manufacturing business. The business is currently earning about \$350,000 per year and, in recent years, Mr. Copley has been using about \$200,000 per year of this amount to meet his personal needs. The remainder has been invested in the business. The business is carried on in a province with a combined federal/provincial tax rate on income eligible for the small business deduction of 11%.

Mr. Copley employs his spouse in the business and, during the summer months, his children.

Mr. Copley has come to you for advice concerning his business. He is considering the possibility of incorporating the business and is interested in knowing whether this will be an advantageous move from a tax point of view.

Required: Provide Mr. Copley with a list of the advantages and disadvantages of incorporation.

SSP 15-3 Flow through of Interest Income

Mrs. Martin is considering purchasing \$200,000 in bonds that pay \$14,000 in annual interest at 7%. Mrs. Martin will have no other investment income in the year.

The combined federal and provincial corporate tax rate on the investment income of a CCPC is 52%, which includes the ART of 10 2/3%. Mrs. Martin is subject to a federal marginal tax rate of 29% and a provincial marginal tax rate of 17%. The provincial dividend tax credit on non-eligible dividends is 25% of the dividend gross up.

Required: Prepare calculations that will compare the after-tax retention of income that will accrue to Mrs. Martin for the current year if:

- A. The bond investment is owned personally.
- B. The bond investment is incorporated in a CCPC of which she will be the sole shareholder. Assume all after-tax corporate income will be paid to her as taxable dividends.

SSP 15-4 Flow through of Dividend Income

Mr. Martin is considering investing \$200,000 in the preferred shares of a Canadian public company on January 1, 2021. These shares will pay cumulative eligible dividends at a fixed rate of 7%, resulting in annual dividend income of \$14,000. Mr. Martin has no other investment income. The public company does not have an LRIP account.

The combined federal and provincial income tax rate on CCPCs earning investment income is 52%, which includes the ART of 10 2/3%. Any additional income to Mr. Martin would be subject to a federal tax rate of 29% and a provincial tax rate of 17%. The provincial dividend tax credit is 25% of the gross up for eligible dividends and 11% for non-eligible dividends.

Required: Prepare calculations that will compare the after-tax retention of the \$14,000 of dividend income that will accrue to Mr. Martin in 2021 if:

- A. The preferred shares are owned by him personally.

- B. The preferred shares are incorporated within a CCPC of which he would be the sole shareholder and which pays out all after-tax income as taxable dividends.

SSP 15-5

Partner as Individual or Corporation

Cora Yates is an architectural engineer who is joining the real estate firm Glenora Developers as a junior partner. She will join the partnership on January 1, 2021, and will receive a 10% interest in the partnership.

She is considering three different approaches to structuring her participation in Glenora:

Alternative 1 Cora will become a member of the partnership. She will be entitled to a share of the business income of the partnership.

For Alternatives 2 and 3, Cora will establish a wholly owned CCPC that will become a member of the partnership. Assume that the new corporation is not a personal services business and that the specified corporate . The corporation will be a CCPC eligible for the small business deduction. Its share of the small business deduction will be \$50,000 [(10%)(500,000)].

Alternative 2 Her new corporation will pay corporate tax on its full share of the partnership income, with the after-tax funds being distributed to Cora as taxable dividends.

Alternative 3 In this alternative, Cora will receive sufficient salary to reduce the corporation's income to its \$50,000 share of the annual business limit. Corporate taxes will be paid on the remaining taxable income.

Cora knows that a corporation will not provide the benefit of limited liability for her professional actions, but she would like to know if it could be advantageous in maximizing her after-tax income from the partnership.

Cora estimates that for the partnership's fiscal year ended December 31, 2021, her or her corporation's share of the partnership income will be \$70,000 (10% of the \$700,000 business income of the partnership), all of which will qualify as active business income.

Assume Cora is subject to graduated provincial tax rates of 8% on the first \$49,020 of taxable income and 12% on the next \$49,020 and the combined federal/provincial dividend tax credit is equal to the gross up on both eligible and non-eligible dividends. She has combined federal/provincial personal tax credits of \$3,342.

The new CCPC would be subject to combined federal/provincial taxes on income eligible for the small business deduction at a rate of 12% and 27% on any other corporate income.

Cora needs all of the after-tax partnership income for personal purposes as she has no other source of income.

Required: Calculate the after-tax retention of Cora's share of the partnership income for each of the three approaches. Ignore CPP considerations and the Canada employment tax credit. Which approach would you recommend? Briefly explain why this alternative is the best and any other factors she should consider.

SSP 15-6 Income Splitting with Management Company

Dr. Ashley is a successful dentist with an established practice in a major Canadian city. On January 1, 2021, she incorporates a new CCPC, Ashley Management Services, to manage her professional practice and to hold some of her investments. The company's year end is December 31.

Dr. Ashley's husband became unemployed in 2020. She hired him to manage this new company and he is paid a salary of \$18,400 per year. This salary is reasonable in view of the services that he performs for Ashley Management Services.

During its first year of operation, the company had the following revenues:

Interest income	\$ 21,600
Eligible dividends from Canadian public companies	13,900
Management fees	82,900
Rental revenues	34,600
Total revenues	\$ 153,000

In the process of earning these revenues, Ashley Management Services incurred the following expenses, including the salary paid to Dr. Ashley's husband:

Expenses on rental property (including CCA)	\$ 27,800
Mr. Ashley's salary	18,400
Office salaries	25,400
Office rent	8,180
CCA on office and dental equipment	5,700
Other business expenses	2,170
Total expenses	\$ 87,650

The corporation's active business income will be subject to a combined federal/provincial rate of 11%, and its investment income will be subject to a combined federal/provincial rate of 51 2/3% (which includes the ART of 10 2/3%). It is the intended policy of the company to distribute all after-tax funds as taxable dividends.

Mr. Ashley owns 60% of the voting shares of the company. The shares were purchased with funds that he earned in his previous employment. Dr. Ashley owns the remaining 40%.

Dr. Ashley's professional income is such that any additional income she earns will be subject to a combined federal/provincial tax rate of 47%. Mr. Ashley's only income is his salary and taxable dividends from Ashley Management Services. Assume that Mr. Ashley's combined federal/provincial rate is 30% and that the tax on split income (TOSI) would not apply to him. Mr. and Mrs. Ashley reside in a province where the dividend tax credit on both eligible and non-eligible dividends is equal to 25% of the gross up.

Required: Ignore personal tax credits, the Canada employment tax credit, CPP contributions, and GST/HST in your solution.

- A. Calculate the minimum tax payable by Ashley Management Services and its shareholders for 2021 including the total after-tax retention.
- B. Assume Dr. Ashley had decided not to incorporate a new company and instead had received all of the income personally, with no salary paid to Mr. Ashley. Calculate the

minimum tax payable for Dr. Ashley for 2021 including after tax retention.

SSP 15-7

Shareholder Loans

Ms. Marcie Lord owns 60% of the outstanding shares of Lord's Luges Ltd., a CCPC with an August 31 year end. The remaining shares of this company are owned by Ms. Lord's common-law partner, Johnny Buff.

Lord's Luges has been extremely successful and, as a result, has accumulated over \$3,000,000 in cash that is not needed in the business. Because of this, the company has a very generous policy with respect to making loans to employees. Under this policy, any employee (including both shareholders who are also employees) is entitled to:

- A loan of up to \$200,000 to acquire a principal residence at an interest rate of 1%. Loan to be repaid over a five-year period in equal annual instalments plus interest.
- An interest-free loan of up to \$25,000 to purchase an automobile if used to carry out employment duties. This loan is to be repaid over a maximum of five years.

During 2021, Ms. Lord took advantage of the loan policy as follows:

Principal Residence Loan On July 1, 2021, Ms. Lord borrowed \$200,000 from the company. The loan will be repaid over a five-year period in equal instalments of \$40,000 plus interest on January 1 of each year beginning January 1, 2022.

Automobile Loan On September 1, 2021, Ms. Lord borrowed \$25,000 interest free to purchase a car she will use in carrying out her employment duties. She is not sure when she will be able to repay this loan.

In addition to these loans that are available to all of the employees of Lord's Luges Ltd., Ms. Lord receives several other loans that will be used for various personal expenditures:

- **February 1, 2021** Ms. Lord borrows \$35,000 at 1% interest. This loan will be repaid on December 1, 2023.
- **July 1, 2021** Ms. Lord borrows \$25,000 on an interest-free basis. This loan will be repaid on August 30, 2022.
- **December 10, 2021** Ms. Lord borrows \$40,000 at 2% interest. It will be repaid on July 1, 2023.

All repayments are made as scheduled. Assume the prescribed interest rate is 2% for all years.

Required: What are the income tax consequences of receiving each of these loans for the years 2021, 2022, and 2023? Briefly explain your conclusions. Calculate any interest benefit using months instead of days.

SSP 15-8

Loans to Shareholders—Tax Planning

Mr. Arthur Blaine is president and sole shareholder of Blaine Enterprises Limited, a CCPC with 10 employees. He is also employed by the company at a salary of \$77,000 per year. Since arriving at his office this morning by bicycle, two things have come to Mr. Blaine's attention:

1. Mr. Blaine's accountant has submitted financial statements indicating that his company has income before taxes of \$180,000 for the current year. As the company is eligible for the small business deduction, this income is taxed at a rate of about 12%, leaving after-tax earnings of nearly \$160,000.
2. Mr. Blaine's neighbour has just informed him he is planning to put his house on the market. Mr. Blaine is interested in purchasing the house for his habitation and selling or renting his existing home. To purchase it, Mr. Blaine would require \$125,000 immediately.
3. Mr. Blaine is of the view that it would make sense for his corporation to lend him the money on an interest-free basis for a period of 10 years. He believes that there should be no adverse income tax consequences given that he is the sole shareholder of the company and the company will have sufficient cash to make the loan without effecting its business.

Required: As Mr. Blaine's personal and corporate tax advisor, provide your analysis of the income tax implications were the company to make a loan to him for the purchase of a home.

SSP 15-9

Bonusing Down

Morcan Inc. is a CCPC with a single shareholder, Mrs. Nadia Litvak. Since its inception, all of Morcan's income has been from active business income.

For the taxation year ending December 31, 2021, after the deduction of a \$300,000 salary to Mrs. Litvak, Morcan expects to have taxable income of \$750,000. This is the first year during which Morcan's taxable income has exceeded the annual business limit for the small business deduction. Morcan is subject to a combined federal/provincial income tax rate of 27% on active business income in excess of \$500,000 for 2021.

Mrs. Litvak's father is the retired president of Morcan Inc. and he has recently taken an income tax course. He has strongly advised Mrs. Litvak to take out an additional salary of \$250,000 in order to reduce her company's taxable income to the business limit of \$500,000 and save taxes. She is resisting this suggestion because she feels her present salary is more than adequate to meet her current living needs. She will require substantial funds in 2025 when she plans to buy a condo for her daughter after she graduates from university. If she doesn't take out the salary now, Mrs. Litvak plans to take out the needed cash as dividends in 2025.

In Mrs. Litvak's province of residence, assume:

- for 2021 to 2025 the maximum combined federal and provincial individual tax rate will be 52%
- for 2025 the dividend gross up will be 38% for eligible dividends and 15% for non-eligible dividends
- for 2025 the federal dividend tax credit will be 6/11 of the gross up for eligible dividends and 9/13 of the gross up for non-eligible dividends
- for 2025 the provincial dividend tax credit will be 5/11 of the gross up for eligible dividends and 4/13 of the gross up for non-eligible dividends

Required: As Mrs. Litvak's income tax consultant would you advise Mrs. Litvak to bonus down by paying herself additional salary of \$250,000 in 2021, or would you suggest she wait until she needs the funds in 2025 and distribute the necessary amount as a taxable dividend? Justify your conclusion.

SSP 15-10

Salary vs. Dividends—Required Amount

Miss Morgan is the sole shareholder of a CCPC that carries on a successful retail business. All corporate income is from an active business subject to a combined federal and provincial income tax rate of 12%.

Miss Morgan has other sources of income that place in the highest federal income tax bracket of 33% and the highest provincial income tax bracket of 18%. The provincial dividend tax credit is equal to 25% of the dividend gross up for non-eligible dividends.

During 2021, Miss Morgan expects corporate net income of \$170,000. This amount takes into consideration a deduction for the payment of salary to her of \$84,000.

Miss Morgan is planning to take an extended holiday in January and February of 2022. She anticipates she will need an extra \$20,000 in cash in December 2021. The company has sufficient cash to fund that amount as either salary or dividends. Any dividends paid would be non-eligible.

Required: Determine the pre-tax amount that would be required as salary or dividends to provide Miss Morgan with the after-tax amount of \$20,000. Which alternative would have the lowest tax cost to Miss Morgan and her corporation?

SSP 15-11

Salary vs. Dividends—Optimum Mix

Robert Lucas is the sole shareholder of Speelburg Films Ltd., a CCPC with a December 31 year end. For 2021, it has income, before consideration of additional salaries or dividends, of \$123,000, all of which is active business income.

Because of large amounts of capital expenditures during the year, the total amount of cash available for corporate income taxes, dividends, or salary is only \$49,000.

As the corporation is in its formative years, it requires the full-time attention of Mr. Lucas. As a result, Mr. Lucas has no other source of income. For 2021, he has available income tax credits that would reduce his combined federal/provincial income tax by \$3,900.

Other relevant information:

- In his province of residence, the income tax rate for individuals on the first \$49,020 of taxable income is 6%.
- In his province of residence, the provincial dividend tax credit is equal to 35% of the gross up on eligible dividends and 30% of the gross up on non-eligible dividends.
- The provincial income tax rate on corporate income eligible for the small business deduction is 2%. There are no provincial payroll taxes.

Required: Ignore the required CPP contributions and the Canada employment tax credit when answering Parts A to D.

- A. Determine the after-tax cash Mr. Lucas will retain if all of the company's cash is used to pay income taxes and salary.
- B. Determine the after-tax cash Mr. Lucas will retain if the company uses its existing cash to pay the maximum possible dividend.

- C. Can Mr. Lucas improve his after-tax cash retention by using a combination of salary and dividends? Explain your conclusion.
- D. If your answer to Part C is yes, determine the required combination of salary and dividends that will maximize after tax cash for Mr. Lucas. Calculate the amount of the after-tax cash retention.
- E. Briefly list any other factors that Mr. Lucas should consider in deciding whether to receive dividends or salary.

Chapter 16 Self-Study Problems

Solutions are available in the Study Guide.

SSP 16-1

Determination of Transfer Prices

Ms. Audrey Flack has operated a gift shop for 15 years as a sole proprietorship. After considerable analysis, she has decided that it is time to incorporate her business. On December 1, 2021, she will create a new corporation of which she will be the sole shareholder and sell the following to the new corporation:

	Tax Cost	FMV
Cash	\$ 27,000	\$ 27,000
Accounts receivable	51,000	45,000
Inventories	73,000	88,000
Furniture and fixtures (UCC)	38,000	45,000
Goodwill (UCC)	Nil	150,000
Totals	\$189,000	\$355,000

The capital cost of the furniture and fixtures is \$62,000.

Ms. Flack did not deduct a reserve for bad debts in 2020.

Ms. Flack will receive no consideration other than shares.

Required:

- A. Determine the income tax consequences to Ms. Flack if the business properties are sold at the FMV listed above on December 31, 2021.
- B. Indicate the elections that could be used by Ms. Flack to reduce the amount of any income that would occur as a result of a sale of the properties at FMV to the corporation.

SSP 16-2

Determination of Transfer Prices

For nearly 20 years, Ms. Monica Speaks has carried on a successful manufacturing business as a sole proprietor. During much of this period you have constantly reminded her that there would be many advantages associated with incorporation, including the availability of the small business deduction. In the past, she has indicated that she has all of the money she requires and simply cannot be bothered with the complications associated with incorporating her business. However, in late 2021, you have finally convinced her that incorporation may be the best course of action.

She indicates that she is still concerned with respect to income tax that might arise on the incorporation of her business. In response, you have indicated that ITA 85(1) provides a method that will result in little or no income tax. As a consequence, she agrees to proceed with incorporation. She will be the only shareholder of the newly incorporated CCPC Speaks Inc.

The incorporation of the business will take place on October 1, 2021. You have prepared the following list of business assets that will be transferred along with their current FMV and relevant tax cost:

	Tax Cost	FMV
Cash	\$ 36,300	\$36,300
Accounts receivable	78,500	78,500
Inventories	261,000	311,000
Land	196,000	282,000
Building (Cost = \$155,500)	103,600	253,000
Equipment (Cost = \$222,000)	67,000	32,500
Goodwill	Nil	339,000
Total	\$742,400	\$1,332,300

The tax cost shown for the building, equipment, and goodwill is the UCC immediately prior to the sale of the business properties to the new company.

Ms. Speaks has only authorized the use of ITA 85(1) with respect to specific properties if there is an income tax advantage in doing so.

Required:

- A. Indicate which properties should be sold to the new company using ITA 85(1).
- B. Given that Ms. Speaks wishes to minimize any income tax consequences of the incorporation, determine the minimum elected amount that can be chosen for each eligible property.
- C. Describe the income tax consequences for both Ms. Speaks and Speaks Inc. if the minimum elected amount is chosen for each eligible property.

SSP 16-3 Simple Non-Depreciable Asset Transfer—Three Cases

Ahmed Sindren owns land that he acquired several years ago for \$230,000. An appraiser estimates that the current FMV of the land is \$660,000. He wishes to sell the land to a new corporation, Sindren Inc., in which he is the sole shareholder. A joint election will be filed under ITA 85(1).

Mr. Sindren is considering these three different alternatives to selling the land to the corporation:

Alternative 1 Mr. Sindren will select an elected amount equal to the ACB of the land of \$230,000. Consideration will consist of shares of the corporation with a FMV and legal capital of \$660,000.

Alternative 2 Mr. Sindren will select an elected amount of \$500,000, in return for consideration that consists of shares of the new corporation with a FMV and legal capital of \$660,000.

Alternative 3 Mr. Sindren will select an elected amount of \$500,000, in return for consideration that consists of a promissory note of \$500,000 and shares of the corporation with a FMV and legal capital of \$160,000.

Required: For each of the three alternatives, determine:

- The immediate income tax consequences of the sale.
- The ACB of the land to the corporation.
- The ACB of the share consideration.
- The PUC of the share consideration.

SSP 16-4**ACB of Consideration and PUC**

Mr. Jeremy Steel intends to sell land that he owns to a new corporation. The ACB of the land is \$225,000 and the FMV is \$625,000. Mr. Steel will jointly elect with the corporation under ITA 85(1) to minimize the income tax consequences by choosing an elected amount of \$225,000.

Mr. Steel is considering the following alternative consideration packages:

	Alternative		
	One	Two	Three
Promissory note	\$150,000	\$175,000	\$210,000
Preferred shares	50,000	450,000	Nil
Common shares	425,000	Nil	415,000
Total	\$625,000	\$625,000	\$625,000

All of the amounts in the preceding table represent the FMV.

Required:

- A. For each of the three alternatives, determine the tax cost (ACB) of each type of consideration received by Mr. Steel.
- B. For each of the three alternatives, determine the PUC of the share consideration.

SSP 16-5**PUC/ACB and Redemption of Shares**

Mr. Lardner carries on a business of the distribution of paper products as a sole proprietorship. He wishes to incorporate the business within a new corporation (Lardner Distribution Ltd.) in which he will be the sole shareholder.

Mr. Lardner has agreed to file a joint election under ITA 85(1) to minimize the income tax consequences for any business properties that are eligible for the election.

Business properties that are eligible for the election have a tax cost of \$467,000 and a FMV of \$726,000. Business liabilities which will be assumed by the company total \$122,000.

Mr. Lardner will sell the business properties to the corporation for \$726,000. The company will pay consideration that consists of the assumption of the business liabilities of \$122,000, the issuance of a promissory for \$128,000, preferred shares with a FMV of \$150,000, and common shares with a FMV of \$326,000. Since the total consideration is equal to the FMV of the properties sold there will be no mismatches of value.

Immediately after the incorporation of the business the company redeems all of the preferred and common share consideration issued on the incorporation of the business. The company borrows the necessary funds to redeem the shares. Lardner Distribution Ltd. does not have a balance in its GRIP account at the end of the year.

Required:

- A. Determine the ACB for both the preferred and common shares issued as consideration.
- B. Determine the PUC for both the preferred and common shares issued as consideration.
- C. Determine the income tax consequences to Mr. Lardner as a result of the redemption of the

preferred and common shares issued as consideration.

SSP 16-6 Transfers to a Corporation and Sale/Redemption of Shares

Some years ago, Mr. Karl Bodin acquired a potential business location consisting of land and a building. The cost was \$1,350,000, with \$250,000 of this total being the estimated value of the land and \$1,100,000 for the building. In order to finance this purchase, he acquired \$500,000 in funds by mortgaging the property.

As of January 1, 2021, he is ready to begin carrying on a business but would like to incorporate the land and building within a new corporation that will have a December 31 taxation year end.

The FMV of the land has increased to \$400,000 and the FMV of the building has increased to \$1,400,000. The building was used to earn income and its UCC at January 1, 2021 is \$633,600. The balance owing on the at January 1, 2021 is \$450,000.

The land and building will be sold to a new corporation of which Mr. Bodin will be the sole shareholder. The sale price will be \$1,800,000 (\$400,000 for the land and \$1,400,000 for the building). The corporation will assume the \$450,000 balance on the mortgage and will issue a promissory note to Mr. Bodin in the amount of \$400,000. In addition, Mr. Bodin will receive preferred shares with a FMV of \$950,000.

In order to incorporate the land and building and minimize income tax Mr. Bodin and the company will jointly elect under ITA 85(1). The elected amount for the land will be its ACB of \$250,000 and the elected amount for the building will be \$750,000.

The balance in the corporation's GRIP account at December 31, 2021 is nil.

Required:

- A. What are the income tax consequences of electing at \$1,000,000? Your answer should include any amounts required to be included in Mr. Bodin's income as a result of the sale, as well as the corporation's tax costs for the land and building.
- B. Determine the tax cost (ACB) of the consideration received by Mr. Bodin as a result of the sale.
- C. Determine the PUC of the corporation's newly issued preferred shares.
- D. Determine the income tax consequences to Mr. Bodin if, during 2021, he sells the preferred shares for \$950,000?
- E. Determine the income tax consequences to Mr. Bodin if, during 2021, the company redeems all of the preferred shares for \$950,000?

SSP 16-7 Transfers to a Corporation and Sale of Shares

Mike Danforth has, for a number of years, carried on a business as a sole proprietor in which he sells home improvement products. On January 2, 2021, Mr. Danforth has decided to incorporate the business within Danforth Inc, a newly created corporation. The corporation will have a December 31 taxation year end. Mr. Danforth and the company will file a joint election under ITA 85(1) to minimize the income tax consequences of incorporating the business.

On January 1, 2021, Mr. Danforth's accountant has prepared the following balance sheet

describing the assets and liabilities of the business, their tax costs (ACB, inventory cost, capital cost or UCC), and FMV:

	Tax Cost	FMV
Cash	\$ 2,500	\$ 2,500
Temporary investments	27,500	37,500
Accounts receivable	13,750	12,500
Inventories	17,500	17,500
Prepayments	7,500	7,500
Land	105,000	77,500
Buildings (Cost = \$113,000)	70,000	125,000
Equipment (Cost = \$48,000)	20,000	7,500
Goodwill	Nil	117,500
Total assets	\$ 263,750	\$405,000
Liabilities	(20,000)	(20,000)
Net assets (owner's equity)	\$ 243,750	\$385,000

Other Information:

1. The temporary investments contain securities that have been purchased to absorb a seasonal excess of cash.
2. With respect to the accounts receivable, the \$1,250 difference between their tax cost and their FMV reflects Mr. Danforth's estimate of potential bad debts.
3. The new corporation will assume the outstanding liabilities.
4. In implementing this rollover, Mr. Danforth will be issued a promissory note. Additional consideration, in excess of the maximum amount of NSC that can be received without any income tax consequences, will be received in preferred shares.
5. Mr. Danforth will only use ITA 85(1) for a specific asset if there is an income tax advantage in doing so.
6. On October 1, 2021, Mr. Danforth sells the shares that he received in this rollover for \$208,000. The shares of Danforth Inc. are QSBC shares that qualify for the capital gains deduction. Mr. Danforth has never claimed the capital gains nor does he have a CNIL account balance.

Required:

- A. Advise Mr. Danforth with respect to which balance sheet assets should be excluded and which should be included in the rollover and the elected amount that should be chosen to minimize any income tax for the included items. Indicate the appropriate income tax treatment for any other balance sheet assets that will not be included in the rollover.
- B. Assume that Mr. Danforth only uses ITA 85(1) for those balance sheet assets you have indicated should be included in the rollover. What is the maximum amount of NSC that Mr. Danforth can receive while avoiding any additional income on their sale, and what is the total composed of?
- C. Determine the income tax consequences of the October 1, 2021 sale of shares by Mr. Danforth's.

SSP 16-8**Gift to Related Person—ITA 85(1)**

Mr. Jonathan Cheng is 64 years old and his only living family member is his 35-year-old daughter, Sarah. For over 35 years he has carried on a retail business in Victoria, British Columbia, as a sole proprietor. His daughter has worked in the business for several years and has gradually assumed greater responsibility.

Mr. Cheng would like to retire and have his daughter take over the business. To that end, he has arranged for his daughter to incorporate a new corporation with an initial investment of \$10,000. At the time of incorporation, the cash of \$10,000 is the only asset of the corporation, and Sarah owns the only common shares issued by the corporation. The new corporation will have a December 31 taxation year end.

Mr. Cheng would like to incorporate the business by selling all of the properties assets of the business to the corporation. To minimize the income tax consequences of the sale Mr. Cheng will use the joint election under ITA 22 for the accounts receivables and ITA 85(1) for all other business properties. Because of the personal nature of the services Mr. Cheng provides, there is no saleable value to the goodwill. On January 1, 2021, the tax costs (inventory value, UCC, capital cost, and ACB) and the estimated FMV of the business properties are as follows:

	Tax Cost	FMV
Inventories	\$ 215,000	\$ 232,000
Depreciable property—Class 8 (Note One)	85,000	96,000
Land	197,000	350,000
Building (Note Two)	610,000	900,000
Total	\$1,107,000	\$ 1,578,000
Liabilities	(160,000)	(160,000)
Net of liabilities (owner's equity)	\$ 947,000	\$ 1,418,000

Note One The capital cost of class 8 property is \$116,000.

Note Two The capital cost of the building is \$722,000.

Mr. Cheng will sell the business properties to the corporation for \$1,578,000. The corporation will pay consideration consisting of assuming the liabilities of \$160,000, issuing a promissory note for \$947,000 and issuing redeemable preferred shares based on the FMV difference of \$471,000, which will also be added to the legal capital for the class of shares.

Mr. Cheng will file a joint election with the company under ITA 85(1) to minimize any income taxes on the incorporation of the business. Mr. Cheng will choose an elected amount for each property based on the property's tax cost as indicated.

Subsequent to the filing of the election, in November 2021, the CRA reassesses Mr. Cheng on the basis that the FMV of the land was \$430,000, rather than the \$350,000 that he had indicated when the election was filed. As Mr. Cheng had ignored the repeated warnings from his accountant not to use an outdated appraisal for his estimate of the land's FMV, he will not object to the reassessment.

Required: Ignore the capital gains deduction in your answer.

- A. Taking into consideration the effect of the reassessment, determine the income tax consequences to Mr. Cheng that result from the sale of the business properties to Sarah's corporation. Your answer should include amounts to be included in Mr. Cheng's income as a result of the reassessment, as well as the ACB and PUC of the preferred shares received

as consideration.

- B. Determine the income tax consequences to Mr. Cheng if the corporation redeems his preferred shares for \$471,000 immediately after the reassessment.
- C. Determine the income tax consequences to Sarah of selling all of her common shares for \$90,000 to an arm's-length person immediately after the reassessment.

SSP 16-9

Excess Consideration

In 2020, Mr. Mel Gibber sold land that was non-depreciable capital property to a CCPC of which he was the sole shareholder. The CCPC had been in existence for many years and had been very successful. The ACB of the land was \$475,000 and the estimated FMV \$800,000. There was no price adjustment clause added to the purchase and sale agreement for the land.

In order to avoid any immediate income tax consequences on the sale, Mr. Gibber jointly elected with the company under ITA 85(1) and selected an elected amount of \$475,000. The company issues a promissory note for \$475,000 and issues a special class of redeemable preferred shares for the remaining balance of \$325,000. A nil capital gain was reported for 2020 on the disposition of the land [(1/2) (POD \$475,000 – ACB \$475,000)].

In 2021, the CRA reassessed on the basis that the FMV of the land was only \$650,000 at the time of the sale. Mr. Gibber accepts the reassessment and does not file an objection.

Required:

- A. Determine the income tax consequences to Mr. Gibber of the reassessment.
- B. Indicate the tax costs of the consideration received subsequent to the reassessment.

SSP 16-10

Dividend Stripping

Norton Ltd. is a CCPC, established several years ago, with an initial investment by Ms. Nora Chadwick of \$225,000. In return for her investment, Ms. Chadwick received 22,500 common shares with a PUC of \$225,000. The corporation uses a December 31 taxation year end.

The company has been very successful and, as a consequence, at the beginning of 2021 it is estimated that the current FMV of the common shares is \$2,465,000. For estate planning purposes Ms. Chadwick would like to crystallize some of the accrued gain on her Norton Ltd. shares and combine her shareholding with that of her common-law partner, Mr. Bobby Borque, within a new corporation.

To accomplish this goal, she intends to incorporate a new corporation, Borque Inc. All 100 of the authorized common shares of Borque Inc. will be issued to Mr. Borque, in return for a cash investment of \$1,000.

Ms. Chadwick will subsequently sell all of her shares in Norton Ltd. to Borque Inc for \$2,465,000. Borque Inc will pay her with a promissory note of \$875,000 and redeemable preferred shares valued at \$1,590,000 that have a legal capital of the same amount. She will jointly elect with Borque Inc. under ITA 85(1) with respect to the sale and will choose an elected amount of \$875,000. The sale will take place on January 1, 2021.

Neither of the two companies have a year end GRIP balance.

The shares of Norton Ltd. are QSBC shares for capital gains deduction. Ms. Chadwick's available capital gains deduction in 2021 is \$650,000.

Required:

- A. Explain the income tax consequences of the share sale and the election under ITA 85(1).
- B. Describe how you would change the transaction to improve Ms. Chadwick's income tax position. Determine the income tax implications that would result from this improved approach.
- C. As an alternative to using her capital gains deduction, Ms. Chadwick proposes selling 6,530 shares of Norton Ltd. to Borque Inc. for cash. The shares would be sold for their current FMV and this would produce, in the absence of ITA 84.1, a capital gain of just over \$650,000. Explain the income tax consequences of this proposed transaction.

Show all calculations to support your answers.

SSP 16-11

Capital Gains Stripping—ITA 55(2)

Lardley Inc., is a CCPC. Ten years ago, the company purchased all of the issued common shares of Dardley Ltd. at a cost of \$300,000.

The Dardley shares currently have a PUC of \$450,000, as the company has been successful and its shares have increased in value to \$2,300,000. The safe income attributable to the common shares of Dardley is \$565,000. Dardley has a nil balance in its RDTOH accounts at the end of the taxation year.

The GRIP balance at the year end for each of the two corporations is nil.

Required: Indicate the income tax consequences to Lardley Inc. in both of the following independent situations:

- A. Dardley Ltd. obtains a bank loan in the amount of \$2,000,000 and uses all of these funds to pay a taxable dividend to Lardley Inc. prior to a sale of the shares to Ms. Arden, an arm's-length person, for \$300,000.
- B. Lardley sells the Dardley common shares to Arden Ltd., an arm's-length corporation. A joint election is filed under ITA 85(1) and an elected amount of \$300,000 is chosen. In return for the Dardley shares, Lardley receives as consideration Arden Ltd. preferred shares with a redemption value of \$2,300,000. Immediately after the sale, Arden Ltd. redeems the preferred shares for \$2,300,000.

Chapter 17 Self-Study Problems

Solutions are available in the Study Guide.

SSP 17-1

Section 85.1 Share-for-Share Exchange

In 2014, Jerry Boseman started a retail business as a sole proprietor in rented facilities that were near his residence. He chose not to incorporate the business because he anticipated that there would be losses for at least a few years. As he was employed at the time, he planned to use the losses to save income tax on his employment income.

The business had become profitable towards the end of 2017, at which time he decided to incorporate. The new corporation was called Jerry's Flowers Ltd. and used a December 31 taxation year end.

On January 1, 2018, the following amounts were determined for all of the property of the business:

Tax costs	\$ 986,000
FMV	\$2,340,000

The business was incorporated a few days later when all of the business properties were sold to Jerry's Flowers Ltd for \$2,340,000. An election was jointly filed by Jerry and the corporation under ITA 85(1) and the combined elected amounts equaled \$986,000 to avoid any immediate income taxes. The company paid Jerry with a promissory note for \$500,000 and 1,000 newly issued preferred shares worth \$1,840 each. The only other share issued by the corporation was one common share issued to Jerry for \$1 in cash when the company was incorporated.

On January 1, 2021, Jerry received an offer from Large Flowers Inc. to acquire all of his Jerry's Flowers Ltd. preferred shares. As consideration, he would receive 50,000 shares in Large Flowers Inc. These shares are currently trading at \$75 per share. Jerry is at arm's length with Large Flowers Inc. and will remain so after the share exchange. The shares of Jerry's Flowers Ltd. do not qualify for the capital gains deduction.

Jerry has a 2016 net capital loss balance of \$800,000.

Required:

- Advise Jerry with respect to the income tax consequences if he were to accept the Large Flowers Ltd. share offer. Your answer should consider both the application of ITA 85.1 and opting out of this provision. Ignore the one common share issued to Jerry by Jerry's Flowers Ltd. when the company was incorporated.
- Determine the ACB of Jerry's Flowers common shares to Large Flowers Inc.
- Advise Jerry as to any alternative approaches he might consider to use the 2016 net capital loss balance and minimize any income tax.

SSP 17-2

Section 85.1 Share-for-Share Exchange

At the beginning of 2012, Sarah Hartman started a retail business in rented facilities near her home. As she anticipated losses in the first few years, she did not incorporate. She planned to use these losses to reduce income taxes on her employment income.

By January 1, 2017, the business became profitable, at which point Sarah decided that it was time to incorporate. The new corporation was called Hartman Inc. and used a December 31 taxation year end.

On January 1, 2017, the following amounts were determined for all of the property of the business:

Tax costs	\$ 842,000
FMV	\$1,560,000

On this date, the business was incorporated as Hartman Inc. and all business properties were sold to the company for \$1,560,000. An election was jointly filed by Sarah and the corporation under ITA 85(1) and the combined elected amounts equaled \$842,000 to avoid any immediate income taxes. The company paid Sarah with a promissory note for \$360,000 and 6,000 newly issued preferred shares with a FMV of \$1,200,000. The only other share issued by the corporation was one common share issued to Sarah for \$1 in cash when the company was incorporated.

On January 1, 2021, Sarah received an offer from Grande Ltd. to acquire all 6,000 of the common shares of Hartman Inc. in exchange for 150,000 Grande Ltd. shares with a FMV of \$2,700,000. Sarah is at arm's length with Grande Ltd. at all times. The shares of Hartman Inc. do not qualify for the capital gains deduction.

Sarah has a 2017 net capital loss balance of \$625,000.

Required:

- A. Advise Sarah with respect to the income tax consequences should she accept the Grande Ltd. share exchange offer. Your answer should consider both the application of ITA 85.1 and impact of opting out of this rollover. Ignore the one common share issued to Sarah by Hartman Inc. when the company was incorporated.
- B. Determine the ACB of the Hartman Inc. shares to Grande Ltd.
- C. Advise Sarah as to any alternative approaches she might consider to use her 2017 net capital loss balance and minimize her income taxes.

SSP 17-3

ITA 86(1) Share Exchange

Fiona Boswick started Boswick Industries Ltd. (BIL) more than 20 years ago. She initially acquired 100 common shares for \$250,000 and has not acquired any additional shares since nor has she reduced her shareholding through redemptions or by any other means. The company has a December 31 taxation year end. As the business is running smoothly, she would like to turn the administration of the business over to her twin sons, Charlie and Jack. The brothers are 32 years old.

Ms. Boswick would like to gift her BIL shares to her sons, but is concerned about adverse income tax implications. She has heard a little about estate freeze planning and believes

that it could provide the solution. She has asked for your advice in this matter.

In discussing this situation with Ms. Boswick, you have found that, while she wishes to retain control over BIL, she is prepared to have any future economic growth in the value of the company accrue to the benefit of her two sons. You have learned that each of the sons is prepared to invest \$10,000 of their own funds in the company.

On July 1, 2021, the condensed balance sheet of the company is as follows:

**Boswick Industries Ltd.
Balance Sheet as at July 1, 2021**

Tangible assets (tax costs)	\$12,450,000
Bank loan	\$ 3,465,000
Common shares (100 shares)	250,000
Retained earnings	8,735,000
Total debt and shareholders' equity	\$12,450,000

An independent appraiser has determined that the FMV of the tangible assets are equal to their tax costs. In addition, the appraiser concludes that the FMV of the goodwill is \$2M.

Required: Advise Ms. Boswick. Include in your solution the July 1, 2021, balance sheet after your proposed share transactions.

SSP 17-4

Section 86 Reorganization with Gift

Mr. Mark and his son, Jack, own, respectively, 80% and 20% of the 1,000 common shares of Markit Ltd. They acquired their shares directly from the corporation a few years ago, when it was incorporated for \$8,000 and \$2,000, respectively. The current FMV of the Markit shares is \$2,400,000. The shares of Markit Ltd. do not qualify for the capital gains deduction.

The balance in its GRIP account is nil for all years under consideration.

Mr. Mark wishes to freeze the value of his shares at their current value. To accomplish this goal, he first obtains the necessary corporate law approval to amend the share structure to add additional classes of shares. The approval is evidenced by amended articles of incorporation. Mr. Mark then exchanges all of his common shares for fixed value preferred shares of Markit Ltd. with legal capital of \$8,000 that are redeemable for \$1,600,000. Subsequent to the exchange, his son, Jack, will be the only common shareholder. **Note:** The legal capital of the newly issued preferred shares would generally equal their FMV of \$1,600,000, but the corporate directors may decide to choose a lesser amount, particularly where the shares issued replace other shares. In this case the legal capital of Mr. Mark's common shares would be \$8,000 which then becomes the legal capital of the preferred shares.

Required:

- A. Describe the income tax consequences of the share exchange as a result of the application of ITA 86 to Mr. Mark, including the following:
 - the gift portion;
 - the PUC of the preferred shares;

- the ACB of the preferred shares;
 - the deemed dividend calculation on the exchange; and
 - the capital gain or capital loss calculations on the exchange.
- B. Describe the economic consequences of the share exchange to the company and its shareholders.
- C. Describe the income tax consequences to Mr. Mark if the preferred shares are redeemed at the FMV of \$1,600,000.

SSP 17-5

Section 86 Reorganization with Gift

Ms. Suzanne Platt incorporated Platt Industries Ltd. (PIL). On the incorporation she acquired all of the common shares for \$120,000.

Thanks to Ms. Platt's expertise in managing the company business the FMV of the common shares increased to \$960,000 by December 31, 2017. On that date, she sold 25% of her common shares to her 22-year-old son for \$240,000. The son used funds that he had won in a lottery to pay for the shares.

Ms. Platt decides to retire at the end of December 2021. She would like to give control of the company to her son and freeze the value of her 75% shareholding. At December 31, 2021, the FMV of her shares is \$1,350,000 [(75%)($\$1,800,000$)]. It is her understanding that she can exchange all of her common shares for a combination of non-voting fixed value preferred shares and NSC without incurring any immediate income tax liability. With this objective in mind, she proposes two alternatives to giving up control of the company to her son:

Approach One She exchanges all of her common shares for cash of \$50,000 and preferred shares that are redeemable at her option for \$1,300,000. The legal capital of the preferred shares would be \$90,000.

Approach Two She exchanges all of her common shares for cash of \$50,000 and preferred shares that are redeemable at her option for \$1,270,000. The legal capital of the preferred shares would be \$1,270,000.

The shares of the company are not eligible for the capital gains deduction. The GRIP balance of the company will be nil for all years under consideration.

Required: For each of the two suggested approaches determine:

- A. The gift portion, if any, resulting from the exchange of shares.
- B. The PUC of the preferred shares.
- C. The ACB of the preferred shares.
- D. The proceeds of redemption/disposition that Ms. Platt received for the old common shares of PIL.
- E. The immediate income tax consequences of the share exchange.
- F. The income tax consequences on the redemption of all of the preferred shares for their FMV.

SSP 17-6**Section 87 vs. Section 88**

Ricon Ltd. owns 100% of the shares of Lynn Inc. Ricon acquired the Lynn shares in 2019 at a cost of \$390,000. The current FMV of the shares \$425,000. Lynn Inc. has no debt and deals at arm's length with Ricon Ltd.

The only property owned by Lynn Inc. is land that was acquired for \$175,000 in 2014. The FMV of the land had increased to \$390,000 when Ricon Ltd. acquired control of Lynn Inc. in 2019. The current FMV of the land is \$425,000. Ricon Ltd. never received any dividends from Lynn Inc while it was a shareholder.

During 2021, the two companies wish to combine using either a vertical short form amalgamation (ITA 87(11)) or by having Lynn Inc wind-up into Ricon Ltd (ITA 88(1)).

Required: (1) From an income tax perspective only, which option would you recommend? (2) Would your answer change if you took non-tax factors into consideration? Explain your conclusion.

SSP 17-7**Winding-Up of a Corporation**

Kruger Ltd. is a CCPC with a December 31 taxation year end. The company was incorporated 10 years ago. Due to increased competition and an inability to adapt to the rapidly changing technological advancements in the industry, it appears unlikely that Kruger Ltd. will be able to earn a satisfactory return on its invested capital in the future. As a consequence, the shareholders have agreed to liquidate the corporation's assets and to dissolve the corporation.

In contemplation of the dissolution, a balance sheet has been prepared based on the tax costs of its property and liabilities as at May 31, 2021.

**Kruger Ltd. Balance Sheet
As at May 31, 2021**

Inventories (FMV and tax cost are equal)	\$ 35,000
RDTOH (non-eligible)	27,000
Land—ACB	623,000
Building—UCC	586,000
Total	\$1,271,000
Liabilities	Nil
PUC	\$ 447,000
CDA	215,000
Other retained income	609,000
Total	\$1,271,000

Other Information:

1. The FMV of the land is \$1,243,000.
2. The capital cost of the building is \$775,000 and the FMV \$1,173,000.
3. The ACB and PUC of the common shares are both \$447,000.
4. The GRIP balance is always nil.
5. All of the corporate properties are sold on June 1, 2021, for their FMV. The after-tax proceeds are distributed to shareholders on June 20, 2021.

6. The provincial income tax rate on corporate income eligible for the small business deduction is 3% and 13% for all other corporate income.
7. No dividends have been paid in the previous two years.
8. No income was earned for the period January 1, 2021 to May 31, 2021.
9. The adjusted aggregate investment income in 2020 was nil.

Required:

- A. Calculate the amount that will be available for distribution to the shareholders after the dissolution of the company.
- B. Determine the income tax consequences to the shareholders as a result of the corporate distributions on the cancellation of their shares. Assume that any elections or designations are made to minimize any income taxes payable by the shareholders.

SSP 17-8**Sale of Assets vs. Shares**

Mr. Carl Lange is 78 years old and has no living relatives. For many years, he has been the sole shareholder of Alcove Ltd., a CCPC with a December 31 taxation year end. The PUC and the ACB of the shares owned by Mr. Lange are both \$135,000. The company has never issued any other shares.

Mr. Lange has decided to sell the company business and devote his attention to his interest in nineteenth-century poetry.

He has received two offers. The first is an offer to purchase all of the issued shares for \$2,380,000. A second offer has been made to acquire the corporate business by purchasing the assets. The specific assets that would be bought and the purchase prices that would be paid are as follows:

Accounts receivable	\$ 91,000
Inventory	298,000
Land	656,000
Building	652,000
Goodwill	719,000
<u>Total</u>	<u>\$2,416,000</u>

Both offers would require the purchase to take place on December 30, 2021.

The balance sheet of Alcove Ltd. is as follows immediately prior to the proposed sale:

Cash	\$ 529,000
Accounts receivable (face amount = \$98,000)	83,000
Inventory at tax cost	237,000
Land ACB	167,000
Building at carrying value*	215,000
<u>Total</u>	<u>\$1,231,000</u>
Liabilities	\$ 355,000
Share capital (equal to PUC)	135,000
Retained earnings	741,000
<u>Total</u>	<u>\$1,231,000</u>

*The capital cost of the building was \$582,000, and it is the only depreciable property in its class. The UCC balance for the class is \$176,000.

On December 30, 2021, there is no balance in the company's CDA, RDTOH, or GRIP accounts. The company business broke even in 2021 and there is neither a business profit nor a business loss.

On income that is eligible for the federal small business deduction, the provincial rate is 3%. On all other corporate income, the provincial rate is 14%.

Mr. Lange will have other personal sources of income in excess of \$250,000 and, as a consequence, his income tax rate on all additional income will be 33% federally plus 18% provincially. He resides in a province where the provincial dividend tax credit on eligible dividends is 5/11 of the gross up and 4/13 on the non-eligible dividend gross up. Mr. Lange has not used any of his capital gains deduction.

If Mr. Lange accepts the offer to purchase the corporate business' assets, a joint election will be filed under ITA 22. The company will be dissolved shortly after the sale of the corporate assets and the final distribution to Mr. Lange.

Required: Determine which of the two offers will provide Mr. Lange with the largest amount once all personal and corporate taxes have been paid. Ignore any alternative minimum tax (AMT) considerations. All relevant elections or designations will be made.

Chapter 18 Self-Study Problems

Solutions are available in the Study Guide.

SSP 18-1

Existence of Partnership

Wayout Ltd. is a company that has operated a vinyl record business for years. Wayout owns three buildings in Toronto and operates a store in each building. The management always believed that records would make a comeback and refused to introduce CDs. As a result, Wayout Ltd. is expected to declare bankruptcy within the next few months. If Wayout Ltd. sold all its property, there would be significant income tax losses. As Wayout has had no profits for years, the losses cannot be used as a carry back. Wayout's accountant recommends the following plan to stave off bankruptcy:

1. A general partnership will be formed and a partnership agreement written up with Wayout Ltd. as the managing partner.
2. The partnership agreement will provide the following:
 - the required capital contributions by each partner;
 - the profit/loss sharing ratios (1% to Wayout and 99% split equally among the other partners);
 - the appointing of accountants to file necessary partnership information returns;
 - that each partner will have a say in the management;
 - that the property contributed by Wayout Ltd. is partnership property; and
 - that the partnership will be dissolved upon the final sale of partnership property.
3. Wayout Ltd. will contribute all of the property from two of its locations, including the land and buildings. The property will be transferred on a rollover basis.
4. Ninety-nine individual Canadian investors will each contribute \$10,000 to the partnership.

If this plan is put into place, Wayout Ltd. will have access to almost \$1 million of new capital to deal with creditors and invest in the remaining store. In addition, it is anticipated that each partner will be allocated \$50,000 in losses. The estimated income tax savings, assuming a marginal income tax rate of 40%, will be \$20,000.

Required: Will a valid partnership be created? Analyze the facts using the three elements of a partnership. Ignore other income tax implications.

SSP 18-2

Partnership vs. Joint Venture

Mr. Marrazzo owns an undeveloped parcel of land in Suburbia. He purchased the land four years ago with the intention of developing residential lots. The land cost \$400,000 and has a FMV of \$1,300,000 as of December 1, 2021.

Banks are reluctant to lend for real estate development, so Mr. Marrazzo has been unsuccessful in obtaining the \$1,200,000 financing that is required for site servicing costs. Digger Inc., a heavy equipment supplier, agrees to provide the required financing on an interest-free basis for 50% of the profits from the sale of the lots.

Mr. Marrazzo proceeds with this plan in 2021; however, site servicing and lot sales do not begin until 2022. Site servicing costs during 2022 total \$1,200,000. All the lots are sold before

December 31, 2022 for proceeds of \$4,400,000.

The preceding events could have been organized under several different scenarios. Two possibilities are as follows:

Case A A partnership is created with Digger Inc. on December 1, 2021. Mr. Marrazzo transfers the land on a rollover basis to the partnership under the provisions of ITA 97(2), which allows him to sell the land to the partnership at its ACB, allowing him to defer the accrued gain on the land. The partnership agreement specifies that Mr. Marrazzo is entitled to 100% of the gain that has accrued on the property to December 1, 2021, and 50% of any subsequent gains.

Case B He enters into a joint venture agreement with Digger Inc. on December 1, 2021. He sells the property to Digger Inc. on December 1, 2021. As no rollover is available, this sale takes place at FMV. Digger Inc. will provide Mr. Marrazzo with 50% of the profits resulting from the sale of the land.

Required: Calculate the amount that will be added to Mr. Marrazzo's 2021 and 2022 net income for Case A and Case B and compare the results.

SSP 18-3

Partnership Income Allocation

Mr. Baker and Mr. Caldwell are members of a partnership that provides accounting services. The partnership's income statement for the year ending December 31, 2021, is as follows:

**Baker and Caldwell
Partnership Income Statement
Year Ending December 31, 2021**

Fees received in cash		\$403,000
Capital gains on temporary holdings of Canadian securities		14,000
Eligible dividends received from Canadian corporations		48,000
Total revenues		\$465,000
Less expenses:		
Salaries and wages	(\$197,000)	
Rent on office space	(19,200)	
Interest on bank loans	(5,800)	
Amortization—Office furniture and equipment	(12,500)	
General office expenses	(28,400)	
Charitable donations	(7,200)	
Convention registration fees	(2,800)	(272,900)
Net accounting income		\$192,100

Other Information:

1. The partnership agreement provides that all income and losses are to be shared equally.
2. The salaries and wages reported on the income statement include a payment of \$44,000 to each of the two partners. The convention fees were for the two partners to attend the annual CPA conference.

3. Both partners use their personal vehicles for business purposes and pay their own operating expenses. Mr. Caldwell's car cost \$24,000 and, at the beginning of the current year, it had a UCC of \$13,500. His operating expenses for the year were \$4,000, for a total of 48,000 kilometres driven. Only 25% of the kilometres driven were for personal use.
4. At the beginning of the current fiscal year, the partnership had fees receivable from clients of \$27,000. At the end of the year, the corresponding balance was \$56,000. These receivables have not been included in the determination of partnership net income.
5. At the beginning of the year, the UCC of the office furniture was \$26,000. During 2021, computer equipment was purchased for \$8,500. Prior to this time, all computer equipment was leased.
6. The partnership makes regular annual contributions to a registered charity.
7. Assume that neither partner is subject to the highest tax rate of 33%.

Required: Calculate the minimum net income for Mr. Caldwell for 2021. Include in the calculation Mr. Caldwell's share of business income. Also indicate other amounts that would be allocated to Mr. Caldwell by the partnership, as well as any deductions or tax credits that can be used to reduce federal tax payable that result from partnership allocations. Ignore GST/HST and PST considerations.

SSP 18-4

Partnership Income Allocation

Jennifer, Christine, and Danny recently graduated from college and began a coffee bean roasting business called the Canadian Coffee Club (CCC) that they operate as a partnership. They share profits and losses equally.

Their accountant has prepared the following statement for the year ending December 31, 2021:

Canadian Coffee Club		
Partnership Income Statement		
Year Ending December 31, 2021		
Gross business revenues		\$ 86,000
Operating expenses	(\$31,500)	
Administrative expenses	(17,300)	(48,800)
Business income		\$ 37,200

Other Information:

1. Included in operating and administrative expenses are the following:
 - \$2,400 of salaries to each of the three partners
 - \$3,300 of interest to Christine (\$1,300 relates to a bona fide loan she made to CCC and the remaining \$2,000 relates to her capital contribution)
 - \$1,100 paid to Danny for personal expenses
 - \$1,700 to Jennifer as a reimbursement of CCC expenses

- \$1,000 of charitable donations
 - \$1,450 of accounting amortization
2. The partnership is entitled to maximum CCA of \$2,000.
 3. In addition to the business income, the partnership had the following additional amounts of income for 2021:

• Eligible dividends received	\$3,440
• Gain on sale of common shares	6,000

The shares that were sold during 2021 had an ACB of \$11,000. They were sold for \$17,000.

4. Assume that no partner is subject to the 33% federal income tax rate.

Required:

- A. Calculate the partnership income that would be included in the 2021 net income of each partner.
- B. Indicate the amount of any federal tax credits that would be available to the partners as a result of partnership allocations.

SSP 18-5 Partnership Income and Sale of Partnership Interest

Bob and Barry Colt are brothers and CPAs. After several years of working for large public accounting firms, on January 1, 2020, they concluded they would be better off if they formed a partnership.

To this end, each partner contributed \$275,000 in cash. Because Bob has decided he would like to cut back on the hours that he works, his share of the partnership business income will be 40%, with the remaining 60% being allocated to Barry. With respect to other types of income, the partnership agreement specifies the following:

Capital Gains As Bob has made the larger capital contribution, all capital gains recognized by the partnership will be allocated to him.

Dividends Dividends received by the partnership will be allocated equally to the two partners.

Charitable Contributions Charitable contributions made by the partnership will be allocated equally to the two partners.

During the partnership's first taxation year ending December 31, 2020, the partnership has business income for income tax purposes of \$372,466. The partnership had no capital gains or capital losses or dividend income during 2020. The partnership made no charitable donations in 2020. During 2020, Bob withdrew \$85,000, while Barry withdrew \$114,000.

The partnership income statement for the year ending December 31, 2021 is as follows:

Income Statement
BB Colt Partnership
Year Ending December 31, 2021

Revenues		
Operating expenses:		\$626,430
Rent	(\$72,300)	
Amortization expense (Note 1)	(17,466)	
Office salaries	(31,252)	
General office costs	(28,346)	
Meals and entertainment	(9,740)	
Charitable donations	(8,658)	(167,762)
<hr/>		
Operating income		
Other income:		
Gain on sale of shares (Note 2)	\$18,660	\$458,668
Eligible dividends received from Canadian corporations	12,390	31,050
<hr/>		
Accounting net income		\$489,718

Note 1 Amortization expense was calculated using ASPE (Accounting Standards for Private Enterprises). The partnership intends to deduct maximum CCA, which for the year ending December 31, 2021, is \$23,562.

Note 2 The gain resulted from the sale of common shares. The ACB of the shares was \$40,000 and were sold for \$58,660.

During 2021, drawings by Bob total \$113,000, while those of Barry total \$142,000.

Barry's only income is from the partnership. His only tax credits are his basic personal credit and any additional credits resulting from partnership allocations.

On January 1, 2022, Barry sells his partnership interest to an arm's-length individual for \$656,000.

Required: Calculate Barry's federal tax payable for the year ending December 31, 2021. In addition, determine the taxable capital gain or allowable capital loss that would result from Barry's sale of his partnership interest. Ignore any CPP implications.

SSP 18-6

Withdrawal of a Partner

Bob Darin, Matt Monroe, and John Mathis formed a partnership on April 1, 2019. The partnership provides engineering services to a variety of clients and has a December 31 fiscal period. Each partner makes an initial capital contribution of \$200,000.

With respect to the various items that must be allocated to individual partners, the partnership agreement contains the following provisions:

Business Income The business income of the partnership will be shared equally by the three partners.

Capital Gains Capital gains realized by the partnership will be shared equally by Matt Monroe and John Mathis.

Eligible Dividends All of the eligible dividends received by the partnership will be

allocated to Bob Darin.

Charitable Contributions Charitable contributions will be allocated equally to the three partners.

For the period April 1, 2019, to December 31, 2021, the following information is available:

- The partnership business income is \$233,460.
- The partnership realized a \$18,464 capital gain (this amount has not been included in the business income).
- The partnership received eligible dividends totalling \$4,689 (this amount is also not included in the business income).
- During the 2021 fiscal period, the partnership made \$8,460 in charitable donations. (None of the donations are included as part of the business income calculation.)
- Additional capital was required to expand the business and, as a consequence, each partner contributed an additional \$75,000 in cash during the 2021 fiscal period.
- Partner withdrawals in the 2021 fiscal period were as follows: Bob Darin, \$112,000; Matt Monroe, \$234,000; and John Mathis, \$55,000.

Near the end of 2021, John Mathis has announced that he will be withdrawing from the partnership, effective January 1, 2022. After some negotiations, each of the other partners agreed to purchase one-half of his interest in the partnership for \$160,000 each, a total of \$320,000. The payments are to be made on February 1, 2022. The partnership has business income of \$21,000 in January 2022.

John incurred legal and accounting fees in connection with the sale of his interest of \$1,800.

Required:

- A. Calculate the ACB of John's partnership interest as of January 1, 2022.
- B. Determine the amount of John's capital gain or capital loss on the disposition of his partnership interest. Explain how this amount, and any other amounts related to the partnership, will be treated for 2022.
- C. Indicate how the ACB of each remaining partner's interest will be affected by the withdrawal of John from the partnership.

SSP 18-7

Limited Partnership

Yoho Airways became a limited partner in the new Frontier Holidays Partnership on January 1, 2021. A 10% limited partnership interest was purchased for \$50,000 with \$30,000 paid immediately and the remainder of \$20,000 to be paid in January 2022. Yoho's is entitled to a 10% share of all income and losses of the partnership.

Frontier carries on a non-farming business and experienced a \$400,000 loss in 2021, a \$70,000 loss in 2022, followed by no income or loss in 2023. In each of the years under consideration, Yoho Airways has sufficient income from other sources to be able to use any deductible partnership losses.

The limited partnership uses a calendar-based fiscal period.

Required: For each of 2021, 2022, and 2023, calculate the following for Yoho Airways:

- The ACB at the end of the year
- The ARA
- The LPL for the year
- The deductible partnership loss for the year
- The LPL at the end of each year

SSP 18-8 Partnership Winding-Up & Transfer to Corporation

In 2017, Jack Porter, Cid Quinn, and Norman Roberts established the Porter, Quinn, and Roberts Partnership. At the time the partnership was formed, each of the partners contributed \$350,000 in cash. The partnership agreement provides for the equal sharing of all income and losses. The fiscal period of the partnership ends on December 31.

On January 1, 2021, the ACB of the interests of the three partners is as follows:

Jack Porter	\$ 382,000
Cid Quinn	526,000
Norman Roberts	726,000
Total	\$1,634,000

The total tax cost of the partnership property equals \$1,634,000 and the FMV is \$2,342,000. On January 2 of the current year, all the partnership property is sold to a taxable Canadian corporation at its FMV of \$2,342,000. An election is filed under ITA 85(2) and a combined elected amount of \$1,634,000 is chosen.

The corporation pays the partnership the following consideration:

Cash	\$ 722,000
Preferred shares (at FMV)	540,000
Common shares (at FMV)	1,080,000
Total consideration	\$2,342,000

On February 20, 2021, the partnership is wound up and partnership property is distributed to the three partners who receive the following amounts:

	Porter	Quinn	Roberts	Total
Cash	\$ 78,000	\$222,000	\$422,000	\$ 722,000
Preferred shares	180,000	180,000	180,000	540,000
Common shares	360,000	360,000	360,000	1,080,000
Total	\$618,000	\$762,000	\$962,000	\$2,342,000

Required:

- A. Determine the ACB of the share consideration received by the partners on the winding-up of the partnership.
- B. Calculate the 2021 income tax consequences to each partner as a result of the disposition of their partnership interests on the winding-up of the partnership.

Chapter 19 Self-Study Problems

Solutions are available in the Study Guide.

SSP 19-1 **Transfer of Property to and from Trusts**

Each of the following independent cases involve gratuitous contributions of property to trusts by an individual. Two of the cases also involve capital distributions from trusts to capital beneficiaries.

- A. A gift of depreciable property is made to establish an inter vivos trust in favour of the settlor's adult children. The capital cost of the property to the settlor was \$23,300. On the date of the gift, the UCC was \$15,400 and the FMV was \$26,400.
- B. A gift of depreciable property is made to establish an inter vivos trust in favour of the settlor's adult children. The capital cost of the property to the settlor was \$19,500. On the date of the gift, the UCC is \$12,400 and the FMV \$15,200. At a later time, when the property is distributed to a capital beneficiary, the UCC is \$13,600 and the FMV \$17,600.
- C. A contribution of non-depreciable capital property is made to establish a qualifying spousal testamentary trust. The ACB of the property to the deceased spouse was \$18,200, and the FMV is \$76,400. At the time of death, the deceased individual had a net capital loss balance of \$91,500.
- D. A gift of non-depreciable capital property is made to establish an inter vivos trust in favour of the settlor's adult children. The ACB of the property to the settlor is \$85,400 and the FMV \$123,200.
- E. A gift of non-depreciable capital property is made to establish an inter vivos trust in favour of the settlor's adult children. The ACB of the property to the settlor was \$43,200 and the FMV is \$51,600. At a later time, when the FMV of the property has increased to \$61,400 the property is distributed to a capital beneficiary.
- F. Capital property is contributed to establish an alter ego trust. The ACB of the property is \$14,200 and the FMV \$23,100.

Required:

For each case indicate:

- 1. The income tax consequences to the settlor that result from the contribution of property to the trust assuming the optimum transfer price (POD) to the settlor.
- 2. The tax cost of the property to the trust.
- 3. In those cases where property is distributed to a capital beneficiary, the income tax consequences to the trust and the tax cost of the property to the beneficiary.

SSP 19-2 **Graduated Rate Estate (GRE)—Tax Payable**

On June 6, 2021, Mr. Fred Masters died at his home in Corner Brook, Newfoundland. The terms of his will required that all of his estate be transferred to a testamentary trust with his adult children as beneficiaries. However, at December 31, 2021, because of legal complications, none

of the property of the estate has been transferred to the testamentary trust and remains under the control of the executor.

The executor files a T3 tax return for the fiscal period ending on December 31, 2021, designating Fred's estate as a GRE. While the executor could have chosen a non-calendar taxation year, it was decided to use December 31.

During the period June 7, 2021, through December 31, 2021, the GRE has the following amounts of income:

Eligible dividends received		\$ 87,000
Interest on British bonds (net of 15% foreign withholding tax)		93,500
Rental income:		
Rental revenues	\$128,000	
Rental expenses other than CCA	(74,000)	
CCA claimed	(33,000)	21,000
<u>Total income</u>		<u>\$201,500</u>

On December 31, 2021, the executor pays 30% of the income to Mr. Masters' daughter, Joan Masters, 50% to Mr. Masters' son, Charles Masters, and the remaining 20% is left in the GRE. Fred Masters anticipated that it would take some time before the executor could transfer the estate to the trust for his children and as a result specified these fixed distributions in his will. Ignore the potential application of TOSI.

Required:

- For the fiscal period ending on December 31, 2021, determine the net and taxable income for the GRE and the net and taxable income for each beneficiary.
- Calculate the federal income tax payable for the GRE for its taxation year ending on December 31, 2021.

SSP 19-3 Graduated Rate Estate (GRE)—Federal Income Tax Payable

Mr. Rolly Rowand died on July 1, 2020, and his will calls for all of his estate to be transferred to a testamentary trust. The beneficiaries of the testamentary trust are Rolly's spouse, Rowena, and his adult son, Roger. There have been significant legal complications in transferring the estate to the trust. As a consequence, on June 30, 2021, the estate is still under the administration of the executor.

Given this situation, the executor files a T3 return for the non-calendar fiscal year ending June 30, 2021, designating the estate as a GRE.

During the period July 1, 2020, through June 30, 2021, the following amounts are reported for the GRE:

Business income	\$20,000
Interest	3,000
Non-eligible dividends received from CCPC	50,000
Gross rents received	12,000
Rental expenses	6,000
CCA on rental property	2,000

As he anticipated difficulties in settling his estate, Rolly's will provides that the executor should make fixed distributions of his estate's income until such time as estate is settled with a transfer to the testamentary trust. All distributions are to be made on the last day of each fiscal period of the GRE.

Assume his will contained the following instructions:

Alternative One One-half of any dividend income is to be retained in the GRE. The remaining one-half of the dividend income, as well as all other income, is to be paid 60% to Rowena and 40% to Roger.

Alternative Two All GRE income is to be distributed to Rowena and Roger on a 60-40 basis.

Rowena and Roger's only income is from the GRE. Their only tax credits are the basic personal credit and any credits that relate to allocations from the GRE. Ignore the potential application of TOSI.

Required: For each alternative:

- A. Calculate net and taxable income and federal income tax payable for the fiscal year ending June 30, 2021, for the GRE.
- B. Calculate net and taxable income and federal income tax payable for Rowena and Roger for the year ending December 31, 2021.
- C. Compare the amount of federal income tax payable under each of the alternatives and explain the difference.

SSP 19-4

Inter Vivos Trusts—Tax Payable

Ms. Sally Jurgens is a successful advertising executive. About 10 years ago, she transferred a number of investments into a trust in favour of her two children. The taxation year of the trust ends on December 31, and Ms. Jurgens has no beneficial interest in either the income or capital of the trust.

Under the terms of the trust, her daughter, Jessica, is to receive 45% of all of the income of the trust, while her son, Joseph, is to receive 40% of the income. Jessica is 32 years of age and Joseph is 28. Both children are single and their only income is from the trust.

The undistributed income that represents 15% of the trust income is to accumulate and to be paid out to the children at the time of Ms. Jurgens's death.

Trust income figures for the year ending on December 31, 2021, are as follows:

Interest income on GICs	\$126,000
Eligible dividends received	462,000
Revenues from rental property	125,000
Expenses on rental property	83,000

On October 1, 2021, the rental property was sold. The property consisted of an apartment building and the land on which it was situated. The relevant information related to the disposition is as follows:

	Building	Land
POD	\$962,000	\$250,000

UCC	627,000	N/A
Capital cost/ACB	725,000	85,000

This is the first disposition of property by the trust.

Required:

- Calculate the net income and taxable income of the trust, Jessica, and Joseph for the 2021 taxation year.
- Calculate the federal income tax payable for the trust for the 2021 taxation year.

SSP 19-5

Inter Vivos Trusts - Income Attribution

Mrs. Dion plans to settle cash and portfolio investments in establishing a trust. The terms of the trust will provide that:

- 60% of the annual income will be paid to her husband, Mr. Dion.
- 40% of the annual income will be split equally between the Dion twins, who are 20 years old and in university. The timing of payments is at the discretion of the trustee.
- The trust capital will be distributed immediately before the twenty-first anniversary of the trust. The capital distribution will follow the same allocation as the income distributions.

The trust's income consists of interest, taxable dividends, and capital gains.

Required:

- Identify the type of trust that is being used.
- Determine the trust's taxation year end.
- Indicate the persons that will have to include the trust's income in their net income.
- Explain how your answer to Part C would change if Mrs. Dion forms the trust by the settlement of a nominal amount of cash. Mrs. Dion then lends money to the trust to purchase the portfolio investments from her at fair market value.
- Explain how the taxation of the trust income will change if Mr. and Mrs. Dion were living separately because of a breakdown in their marriage.

SSP 19-6

Testamentary Trusts—Transfers of Assets

Mrs. Turner died on October 1, 2020. The capital cost and the FMV of the properties she owned at the time of her death were as follows:

Properties	Capital Cost/ACB	FMV
Principal residence	\$100,000	\$ 265,000
Cottage	152,000	322,000
Warehouse—Land	55,000	75,000
Warehouse—Building (UCC = \$45,000)	85,000	85,000
Investment portfolio	220,000	280,000

According to her will, the principal residence and the warehouse were transferred to a trust for

the benefit of her 32-year-old daughter, Melanie. After Mrs. Turner's death, Melanie moved into the principal residence and intends to live there indefinitely. The trust is to pay for the maintenance of the principal residence.

The cottage and investment portfolio were transferred into a separate trust for the exclusive benefit of Mr. West, Mrs. Turner's second husband.

Mr. West died January 10, 2021. The FMV of all of the properties did not change between October 1, 2020, and January 10, 2021.

Required:

- A. Describe the income tax consequences for Mrs. Turner, her daughter Melanie, and her spouse Mr. West resulting from the transfers of property to the two trusts.
- B. Describe the income tax consequences for Mrs. Turner, her daughter Melanie, and her spouse Mr. West as a result of the death of Mr. West.
- C. As all of Mrs. Turner's estate was immediately transferred into testamentary trusts, it would not have been possible to make a GRE designation since the estate was immediately settled. Would it have been advantageous to delay the transfer of the estate to the two testamentary trusts so that Mrs. Turner's estate could have been designated as a GRE? Explain your conclusion.

Chapter 20 Self-Study Problems

Solutions are available in the Study Guide.

SSP 20-1

Part I Tax on Non-Residents

The following material describes several independent cases that involve U.S. residents, including U.S. resident corporations that have some type of Canadian source income.

Case A

Sharon Broley is a U.S. resident who maintains a home in the U.S. However, during the current year she accepts an employment contract that requires her to work for three months in Vancouver. The salary is \$12,000 per month, plus an allowance of \$2,500 per month to cover her living expenses. The contract is with a Canadian corporation that is head quartered in Canada and that is responsible for paying both the salary and the allowance.

Case B

Mariah Capri is a U.S. resident. She is asked by her U.S. employer to spend two months working in Toronto. Her employment income during this period is \$18,000 in U.S. dollars, all of which is paid by her U.S. employer.

Case C

Shae Kira is a U.S. resident. A number of years ago she incorporated a private company in Canada in order to hold several Canadian rental properties. She has been the only shareholder of that corporation from its inception. During the current year, she sells all of the shares, resulting in a gain of \$562,000.

Case D

Rae Downer is a U.S. resident. She is the sole shareholder of a U.S. private company that owns a number of rental properties in western Canada. During the current year, she sells all of the shares in this company, realizing a gain of \$326,000.

Case E

Olex is a U.S.-based manufacturing company. In order to sell its product in Canada, it ships to a warehouse located in Cornwall, Ontario. The company pays a monthly rent on the warehouse and can cancel the arrangement by giving 60 days' notice to the lessor. They have made an arrangement with Martha Faulk to sell their product in eastern Canada. Martha works out of an office in her home. She does not have authority to conclude individual sales contracts without approval from the U.S. head office.

Case F

Orex is a U.S.-based manufacturing company. In order to sell its product in Canada, it ships to a warehouse located in Cornwall, Ontario. The company pays a monthly rent on the warehouse and can cancel the arrangement by giving 60 days' notice to the lessor. They have made an arrangement with Martha Faulk to sell their product in eastern Canada. Martha maintains an office in the warehouse, occupying a significant portion of the total available space. She has the authority to conclude individual sales contracts without approval from the U.S. head office.

Required: For each case, indicate whether the non-resident would be subject to Part I income tax

in Canada.

SSP 20-2

Part XIII Tax on Non-Residents

Each of the following independent cases involves a non-resident individual who has Canadian source income during the current year. All amounts are in Canadian dollars.

Case A

Martha Martin is a resident of the U.S. She owns debt securities that were issued by a Canadian public company. The interest rate on the securities is determined by the level of profits earned by the company. During the current year, she receives interest of \$2,460.

Case B

Brendan Lee is a resident of a country that does not have a tax treaty with Canada. He is the owner of a vacation property in northern Ontario that he rents to Canadian residents. His gross rents for the current year are \$94,000. Expenses related to the property, including maximum CCA, are \$27,000.

Case C

Barry Fox is a resident of a country that does not have a tax treaty with Canada. He owns debt securities issued by a Canadian company that pay interest at a rate that is determined by the profits of the company. During the current year, he receives interest of \$4,680 from this investment.

Case D

Terence Redux is a resident of a country that does not have a tax treaty with Canada. During the current year he earns \$2,685 of interest on a savings account in Canada.

Case E

Karl Marks is a resident of a country that does not have a tax treaty with Canada. During the current year, Karl receives \$8,462 in dividends from a Canadian private company. Karl owns 20% of this company's voting shares.

Required: For each of the cases, explain whether the income received would be subject to Canadian income tax. Where there are alternative tax consequences, determine which of the alternatives would result in the lower tax cost. Explain your conclusion.

SSP 20-3

Ceasing to Be a Resident of Canada

Mr. Howard Rankin terminates his Canadian residency at the end of 2020 and establishes residency in the U.S. as of January 1, 2022. He does not collapse his RRSP before leaving Canada.

On December 31, 2021, Mr. Rankin owns the following property:

	FMV	ACB
City home	\$650,000	\$325,000
Cottage (personal use only)	180,000	45,000
Automobile (personal use only)	22,000	48,000
Interest in an RRSP	220,000	Nil

Shares of a CCPC	80,000	65,000
Shares in Canadian public companies	120,000	42,000

Required: For each of the above properties, indicate the income tax consequences when Mr. Rankin ceases to be a resident of Canada and any potential future income tax consequences, assuming that he does not make any elective dispositions. Explain your conclusions.

SSP 20-4

Foreign Investment Reporting Rules

The following six cases are independent and involve a Canadian resident taxpayer who does not own any other foreign property. All amounts are in Canadian dollars.

For each foreign property, indicate whether foreign reporting is required.

1. A cottage in Woodstock, Vermont, purchased for \$365,000, with a down payment of \$65,000 and the assumption of a \$400,000 mortgage. The cottage is used by the taxpayer and his extended family throughout the year.
2. A building in Canton, Ohio, with a cost of \$1,560,000, is owned by a Canadian corporation in connection with its business and is used exclusively to store the company's products for distribution.
3. Shares in a U.S. public company with an ACB (cost amount) of \$286,000 and a current FMV of \$72,000. One-half of these shares were purchased in the taxpayer's Canadian brokerage trading account and the other half were purchased in the taxpayer's self-directed RRSP.
4. A U.S. bank account and a mortgage receivable resulting from the sale of a rental property to a U.S. resident three years ago. The original amount of the mortgage was \$135,000. However, the amount owing at the beginning of the current year is \$68,000. The taxpayer's bank account in a U.S. bank has a balance of between \$3,000 and \$12,000 throughout the year.
5. A yacht with a cost of \$1,300,000 that was purchased and is docked in San Diego, California. The yacht is used by a Vancouver taxpayer as a venue for her lavish parties.
6. A condo in Fort Myers, Florida, is purchased for \$860,000. The condo is rented to Canadians for nine months of the year and used by the taxpayer the remaining three months.

SSP 20-5

Foreign Source Employment Income

In each of the following cases, determine whether the individual will be subject to income tax in the U.S. Explain your conclusion.

- A. A Canadian resident hockey player is employed during the off season to lead one hockey school in Florida and another in Ontario. The hockey schools are run by a Florida promoter, and the hockey player is paid US\$1,000 per day. Each of the schools lasts for seven days, resulting in total earnings of US\$14,000 for 14 days. The individual has no other U.S. income.
- B. A Montreal theatre production firm employs a Winnipeg expert animator to prepare special three-dimensional animation effects. During the current year, the animator performs the

employment services in California for three periods, each of which is for two months (60 days). In California, the work involves using special animation equipment that is unavailable in Canada. The animator is paid a total of CAN\$150,000 for his employment services in the U.S. This is the only U.S. employment that the individual has ever done and the individual is not expected to return to the U.S. for additional services. The remuneration is paid by the Canadian based theatre.

SSP 20-6 **Dividends Received by a Resident Individual from a Non-resident Corporation That Is Not a CFA**

Mona Lister is a resident of Canada. During 2021, she has the following amounts of income:

Employment income	\$87,000
Dividends from foreign companies:	
Foreign Country 1—Hispanic Ltd. (\$5,750 withholding tax)	23,000
Foreign Country 2—Deutsch Inc. (\$1,400 withholding tax)	14,000

Mona's employer has deducted maximum CPP and EI from her employment income. Mona has no taxable income deductions. Her only tax credits are the basic personal credit, employment-related credits, and any credits related to the dividends received.

Required: Determine Mona's 2021 federal income tax payable.

SSP 20-7 **Taxation of Foreign Affiliate Dividends**

BK Inc. is a Canadian resident corporation with a taxation year that ends on December 31.

BK owns 40% of the shares of two non-resident corporations. The first, Alta Inc., is located in a country with which Canada has a tax treaty. It also has a December 31 year end and, during the year ending December 31, 2021, all of the company's income was from an active business. This income was subject to a foreign income tax rate of 15%.

During 2021, the company paid a dividend of \$85,000 of which \$30,600 was received by BK Inc. This amount reflects a payment of \$34,000 $[(40\%)(\$85,000)]$ to BK Inc., less dividend withholding of taxes of \$3,400 $[(10\%)(\$34,000)]$. On December 31, 2020, Alta Inc. had an exempt surplus balance of \$221,000.

The second non-resident corporation, Bolt Ltd., is located in a country with which Canada does not have a tax treaty or a TIEA. It also has a December 31 year end and, during the year ending December 31, 2021, all of the company's income was from an active business. Bolt Ltd. is subject to a foreign income tax rate of 5%.

During 2021, Bolt Ltd. paid a dividend of \$190,000. BK Inc.'s share of this dividend was \$76,000. However, the foreign country charged a dividend tax of \$11,400 $[(15\%)(\$76,000)]$, providing BK Inc. with a net receipt of \$64,600. On December 31, 2020, Bolt Ltd. had a taxable surplus balance of \$950,000.

Both foreign corporations have only earned active business income since their incorporation. Further, the foreign income tax rate for both corporations on this type of income has remained

unchanged since their incorporation.

All of the shares of the two corporations that are not owned by BK Ltd. are owned by non-resident persons that are not related to BK Ltd.

Required: Determine BK's taxable income and federal income tax payable that results from the receipt of these foreign dividends. In addition, provide a reconciliation that demonstrates that BK's share of Bolt's income is subject to a combined (Canadian and foreign) income tax rate of 25%.

Chapter 21 Self-Study Problems

Solutions are available in the Study Guide.

SSP 21-1

Turnover Tax vs. GST

The government is considering introducing a pure turnover tax, so that businesses will only have to account for and remit tax collected on transactions.

Assume goods normally move from the raw materials supplier, to the manufacturer, to the wholesaler, to the distributor, to the retailer, and finally to the consumer. Assume a sale price of \$100, plus tax, by the raw materials supplier to the manufacturer. There is a markup of 50% of the before tax cost at each subsequent stage. The relevant tax applies to the selling price at each stage.

Required: Determine (1) the GST that would be charged at each stage and the ITC available based on a 5% GST rate and (2) the transaction tax rate required to raise the same amount of tax revenue as the 5% GST rate.

SSP 21-2

Registration Requirements

Chantelle Chance is a hairdresser who began to carry on business October 1, 2020, and has not registered to collect the GST/HST. Quarterly revenues from her business for her first year of operation were as follows:

October to December 2020	\$ 4,000
January to March 2021	6,500
April to June 2021	9,000
July to September 2021	9,500
<u>Total for four quarters ending September 2021</u>	<u>\$29,000</u>

For the calendar quarter ending December 31, 2021, revenues totalled \$11,500.

Required: Advise Chantelle whether registration for the GST is required and include the reasons for your answer. If required, state when GST collection must start and by what date registration must be completed.

SSP 21-3

Regular HST Return

Norton's Variety (Norton) is the registered name of a retail business carried on exclusively in Ontario by Sheila Norton as a sole proprietor. Ontario has an HST rate of 13%.

Norton is an HST registrant that sells both fully taxable and zero-rated goods. In addition, the company provides services that are exempt supplies. HST is filed by Norton on an annual basis.

Norton's income statement for the current year is as follows (none of the amounts include HST):

Revenues:	
Fully taxable goods	\$ 250,000
Zero-rated goods	100,000

Exempt services	<u>150,000</u>	\$ 500,000
Less: Expenses:		
Cost of goods sold—Taxable goods	(\$175,000)	
Cost of goods sold—Zero-rated goods	(60,000)	
Depreciation expense	(40,000)	
Salaries and wages expense	(20,000)	
Interest expense	(5,000)	
Other expenses	(10,000)	(310,000)
Income before taxes		\$ 190,000
Less: Federal and provincial income taxes		(82,000)
Net income for accounting purposes		<u>\$ 108,000</u>

Other Information:

- Purchases of inventory totalled \$185,000 for taxable goods and \$53,000 for zero-rated goods.
- Two capital expenditures were made in the current year. The first was a building purchased for \$480,000 and the second was equipment purchased for \$120,000. Fully taxable and zero-rated supplies account for 40% of the use of the building and 60% is attributable to exempt supplies. Fully taxable and zero-rated supplies account for 30% of the use of the equipment and 70% is attributable to exempt supplies. HST was paid on the purchase of the building and the equipment. All the depreciation expense relates to these two capital expenditures.
- Of the other operating expenses, 91% were attributable to either fully taxable or zero-rated supplies and 9% to exempt supplies.
- Of the salaries and wages, 40% were attributable to employees involved in providing exempt supplies and 60% to employees involved in fully taxable or zero-rated supplies.

Required: Calculate Sheila Norton's HST payable or HST refund for the current year.

SSP 21-4**Regular GST Return**

Lassen Ltd., a company incorporated in Alberta, is an annual filer for GST purposes. Alberta does not participate in the HST and does not have a provincial sales tax.

The following is a summary of the financial statement information for the current year. None of the amounts shown include GST.

Sales		\$5,700,000
Less expenses:		
Cost of goods sold	(\$2,600,000)	
Depreciation expense	(720,000)	
Salaries and wages expense	(640,000)	
Interest expense	(120,000)	
Other expenses	(370,000)	
Income tax	(240,000)	(4,690,000)
Net income for accounting purposes		<u>\$ 1,010,000</u>

Other Information:

- Sales included \$1,200,000 in exempt supplies, \$2,400,000 in zero-rated supplies, and

- \$2,100,000 in fully taxable supplies.
- None of the cost of goods sold are attributable to exempt supplies. Purchases of inventory totalled \$2,400,000. GST was paid on all purchased goods.
 - Two capital expenditures were made in the current year. The first was a building purchased for \$3,000,000 and the second for equipment purchased for \$1,000,000. Fully taxable and zero-rated supplies account for 40% of the use of the building and 60% is attributable to exempt supplies. Fully taxable and zero-rated supplies account for 30% of the use of the equipment and 70% is attributable to exempt supplies. GST was paid on the purchase of the building and the equipment. All the depreciation expense relates to these two capital expenditures.
 - The other expenses are all attributable to fully taxable supplies. Of the office expenses, \$40,000 are for meals of employees while travelling for business purposes. Only 50% or \$20,000 of these expenses are deductible for income tax purposes (ITA 67.1)
 - Of the salaries and wages, 40% are attributable to exempt supplies.

Required: Calculate Lassen's GST payable or GST refund for the current year.

SSP 21-5

Quick Method

Claire, Nicole, Barbara, and Elizabeth Sperry are sisters and each carries on a business as a sole proprietor. All the businesses are located in Alberta. The quick method remittance rate in Alberta is 1.8% for a retail business and 3.6% for a service business.

The sisters provide you with the following annual information with respect to each of their businesses. All sales and purchase amounts include GST. None of the sales or purchases were from zero-rated or exempt supplies and none of the businesses made any capital expenditures during the year.

	Type of Business	Sales	Purchases
Claire	Lawn Maintenance	\$150,000	\$ 35,000
Barbara	Tennis Supplies	150,000	100,000
Nicole	Pro Golf Instruction	120,000	35,000
Elizabeth	Golf Watch Sales	120,000	75,000

Required: Recommend whether any of the businesses should use the quick method to calculate net GST remittances. Show your calculations. Note that the sisters are not associated persons to each other.

SSP 21-6

Regular and Quick Method GST Returns

Larkin Ltd. carries on a retail business located in Ontario. The HST rate is 13%. The remittance rate is 4.4% for a retail business and 8.8% for a service business.

All of the company's revenues and expenses are incurred in Ontario. There are no associated persons and the company files its HST return on an annual basis.

The following income statement has been prepared for the current year. None of the amounts include HST:

Revenues:		
Sales of fully taxable goods	\$103,000	
Provision of exempt services	<u>38,000</u>	\$141,000

Less expenses:		
Cost of goods sold	(\$ 63,000)	
Depreciation expense	(9,000)	
Salaries and wages expense	(8,000)	
Rent expense	(24,000)	
Interest expense	(4,000)	
Other expenses	(12,000)	(120,000)
<hr/>		
Accounting income before taxes		\$ 21,000
Less: Federal and provincial income taxes		(7,000)
<hr/>		
Net accounting income		\$ 14,000
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Other Information:

1. Purchases of inventory in the year totalled \$69,000.
2. The "other expenses" are all attributable to fully taxable supplies.
3. Of the salaries and wages, 22% are attributable to exempt services and the remaining 78% are attributable to taxable supplies.
4. The company purchased equipment at a cost of \$36,160, which includes HST. It is estimated that 60% of the use of the equipment is attributable to taxable supplies and 40% to exempt services. The depreciation expense relates solely to the equipment.

Required:

- A. Calculate Larkin's net HST payable or HST refund for the current year using the regular HST method.
- B. Determine whether Larkin is eligible to use the quick method.
- C. On the assumption that Larkin is eligible to use the quick method at a remittance rate of 4.4%, calculate the HST payable or HST refund for the current year using the quick method.

SSP 21-7**Employee GST Rebate Including CCA**

George Christmas is a resident of Saskatchewan. In addition to the 5% federal GST, Saskatchewan has a provincial sales tax of 6%.

George is employed by a large public company that carries on all of its business in Saskatchewan. The company is a GST registrant and is not a financial institution.

George is required to travel as part of his employment. He uses his own car and personally pays for all expenses. He does not receive any reimbursement or allowance from his employer.

George's car was purchased in July 2020 for \$25,000 plus GST of \$1,250 [(5%)(25,000)] and provincial sales tax of \$1,500 [(6%)(25,000)] for a total of \$27,750. The car is used 100% of the time for employment-related purposes. George's spouse owns a car that the family uses for personal purposes.

During 2020, George claimed \$12,488 of CCA [(30%)(1.5)(27,750)] and a GST rebate on the CCA of \$595 [(\$12,488)(5/105)]. His 2020 income tax return was accepted as filed.

In his 2021 income tax return, George deducted the following amounts in the calculation of his employment income:

Accommodation (includes provincial sales tax of \$480 and GST of \$400)	\$ 8,880
Deductible portion of meals and entertainment (includes provincial sales tax of \$300 and GST of \$250)	5,550
Automobile expenses:	
Gas and maintenance (includes provincial sales tax of \$540 and GST of \$450)	9,990
Interest on automobile loan	2,600
Insurance	1,200
<hr/> Total expenses excluding CCA <hr/>	<hr/> \$28,220 <hr/>

For 2021, George intends to claim the maximum CCA on his car.

Required: Calculate the maximum CCA that George can claim on his car for 2021. In addition, calculate the 2021 GST rebate that George will claim as a result of his deductible expenses. Finally, determine the impact of the 2021 GST rebate on George's 2022 income tax return.

SSP 21-8

New Housing GST Rebate

Martin Walker lives and works in Edmonton, Alberta, and is planning on purchasing a home. He has narrowed down his choice to one of three Edmonton properties. None of the amounts shown includes GST.

	Purchase Price	Planned Improvements
Property A—Used (Note 1)	\$260,000	\$110,000
Property B—Used	387,000	None
Property C—New (Note 2)	323,000	22,000

Note 1 Property A would require major improvements. More than 90% of the interior will have to be replaced. The improvements will be done by the vendor and will be added to the purchase price, resulting in a total price of \$370,000 (\$260,000 + \$110,000).

Note 2 Property C is under construction. Of the planned improvements, \$10,000 will be completed by the builder at the same time that the house is being finished. These costs will be added to the purchase price, resulting in a total price of \$333,000. After the house is finished and transferred to Martin, Martin would finish the remaining improvements using materials with a cost of \$12,000.

Required: Before making any offer to purchase, Martin has asked you to determine the GST and the total out-of-pocket costs of each purchase.

SSP 21-9

New Housing GST Rebate

The following independent cases all involve an individual purchasing a new home in Alberta for a total payment of \$200,000.

Varying assumptions are made with respect to what is included in the \$200,000 payment.

Case A The price includes GST.

Case B The price does not include GST.

Case C The price includes GST, net of the new housing rebate.

Required: For each case determine:

- the pre-rebate amount of GST;
- the amount of the GST rebate that can be claimed;
- who would claim the GST rebate; and
- the net amount of GST that will be paid.