

## Chapter Eleven Test Item File Problems

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### TIF PROBLEM ELEVEN - 1

#### Tax Payable For Individuals Revisited - Essay Questions

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1. ITA 110.2 provides for a deduction of "lump-sum payments", for example a court ordered termination benefit. What tax policy objective is served by this provision?
2. The carry forward periods for losses varies with the type of loss. Briefly describe the carry forward periods that the *Income Tax Act* provides for the types of losses that it identifies.
3. When an enterprise has several types of loss carry forwards, why is it necessary to keep separate balances for each type?
4. Tax advisors will normally recommend that loss carry overs not be used to reduce Taxable Income to nil. What is the basis for this recommendation?
5. Briefly describe the tax treatment of losses on listed personal property.
6. If a taxpayer has both net capital and non-capital loss carry overs and does not have sufficient income in the current and previous years to deduct all of these amounts, which type of loss should be deducted first?
7. John Broley has a \$50,000 non-capital loss carry forward and a \$50,000 net capital loss carry forward. During the current year, his only income is a \$50,000 taxable capital gain. He has asked your advice as to which of the two loss carry forwards he should deduct. What advice would you give him?
8. If an individual dies and has a net capital loss in that taxation year or unused net capital losses from previous years, these balances are subject to a different treatment than would be the case if the individual were still alive. Briefly describe how this treatment is different.
9. What is an Allowable Business Investment Loss? What special tax provisions are associated with this type of loss?
10. What is a Small Business Corporation as defined in the *Income Tax Act*?
11. With respect to the deductibility of their losses, farmers fall into three categories. What are these three categories and how are losses treated in each category?
12. The lifetime capital gains deduction is available when the taxpayer has a gain on the disposition of shares in a "qualified small business corporation". What are the conditions that must be met for an enterprise to be a qualified small business corporation?
13. An individual has a capital gain on qualified farm property. He has no other capital gains during the year. Explain how the annual gains limit would be calculated in determining his lifetime capital gains deduction for the year.
14. In computing Net Income For Tax Purposes, ITA 3 requires that subdivision e deductions be subtracted prior to deducting business or property losses. Explain why this rule is usually beneficial to a taxpayer.
15. What types of current year losses are included in the definition of non-capital losses? What types of losses are not included?

*Tax Payable For Individuals Revisited - Essay Questions*

16. Briefly describe the items that are subject to the tax on split income (a.k.a., kiddie tax).
17. List three types of income that would not be subject to the tax on split income (a.k.a., kiddie tax).
18. Under what circumstances can dividends be transferred from a spouse or common-law partner to a taxpayer?
19. Briefly describe the four major categories of charitable donations.
20. If a taxpayer is donating a non-depreciable capital asset with a fair market value that exceeds its adjusted cost base, a taxpayer can elect any amount between those two values as the amount of his contribution. Why is it generally appropriate to elect the higher fair market value?
21. Capital gains resulting from donations of publicly traded shares are, in general, deemed to be nil. Why is an additional rule required to avoid taxing income resulting from gifts of publicly traded shares that have been acquired through stock options?
22. Compare the tax treatment of foreign tax credits on foreign non-business income with the tax treatment of tax credits on foreign business income for individuals.
23. The alternative minimum tax is an attempt to deal with a tax policy issue. What is this issue and, in general terms, how does the alternative minimum tax deal with this issue?

**TIF PROBLEM ELEVEN - 2****Tax Payable For Individuals Revisited - True Or False**

1. If an individual has no loss carry overs from other years, the current year Net Income For Tax Purposes will be equal to Taxable Income.

True or False?

2. An individual has a non-capital loss. It can be carried back three years and forward indefinitely.

True or False?

3. An individual sells shares in a Canadian controlled private corporation that qualifies as a small business corporation to an arm's length party. The adjusted cost base of the shares is \$50,000 and they are sold for \$30,000. The \$20,000 loss is an Allowable Business Investment Loss.

True or False?

4. A corporation sold a long-term investment in common shares with an adjusted cost base of \$25,000, for \$10,000 during the current year. It also sold a parcel of land that is considered capital property with an adjusted cost base of \$8,000, for \$12,000. Its net allowable capital loss for the year is \$11,000.

True or False?

5. Net capital losses can be carried forward or back, but can only be deducted to the extent of net taxable capital gains in the carry back or carry forward year.

True or False?

6. Jennifer Nash is a plumber in Waterloo, Ontario, who spends all of her weekends and holidays operating a farm she purchased this year. She is confident that within two years her farm will be making a profit. In the current year, the farm had a loss of \$18,000.

- i. In the current year, she can deduct a maximum of \$2,500 of the farm loss against other income.

True or False?

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

True or False?

- iii. Any loss that is not deductible in the current year can only be applied to the extent of farm income in the carry over year.

True or False?

7. During 2016, an individual has taxable capital gains on the disposition of shares in a qualified small business corporation. The lifetime capital gains deduction can be used to eliminate up to \$412,088 of the taxable capital gains on the disposition.

True or False?

*Tax Payable For Individuals Revisited - True Or False*

8. An individual is holding bonds issued in a foreign country. Tax of \$2,000 is withheld in that country from the gross interest of \$10,000. The foreign tax credit deductible from federal Tax Payable cannot exceed \$1,500.

True or False?

9. In situations where such a transfer would result in the creation of, or an increase in, the spousal tax credit for the taxpayer, dividends received by the spouse or common-law partner of the taxpayer can be transferred to him and included in his tax return.

True or False?

10. When an individual makes a gift of publicly traded securities to a registered charity, any capital gain that results from the disposition is deemed to be nil.

True or False?

**TIF PROBLEM ELEVEN - 3****Tax Payable For Individuals Revisited - Multiple Choice****New For 2016/2017****Taxable Income**

1. Kiley Fernald has, at the request of her employer, moved to one of their offices in a different city. Specifically, the move is from Halifax to Toronto. Because of the much higher prices for real estate in that city, her employer provides her with a \$300,000 loan to assist her in acquiring a new residence on January 1, 2016. The loan requires Kiley to pay interest at an annual rate of 1 percent. What amount will be included in Kiley's 2016 Taxable Income as a consequence of receiving this loan? Assume that the prescribed rate is 2.5 percent throughout 2016.
  - A. \$4,500
  - B. \$3,875
  - C. \$7,500
  - D. \$4,125

**Treatment Of Losses**

2. Which of the following statements with respect to loss carry overs is **NOT** correct?
  - A. Losses on the disposition of listed personal property can be carried back 3 years and forward 7 years.
  - B. Restricted farm losses can only be carried over to years in which there is farm income.
  - C. Net capital loss carry overs cannot be deducted in years in which Net Income For Tax Purposes is nil, even if there are taxable capital gains in that year.
  - D. If an individual can deduct either a \$10,000 non-capital loss carry over or a \$10,000 net capital loss carry over, the effect on Taxable Income of deducting either is the same.

**Allowable Business Investment Losses**

3. In 2010, Lorrie Meller use her lifetime capital gains deduction to eliminate a \$10,000 taxable capital gain. During 2016, she had employment income of \$50,000, a capital gain of \$26,000, and a business investment loss of \$30,000. What is the amount of Lorrie's Taxable Income for 2016?
  - A. \$45,000
  - B. \$58,000
  - C. \$46,000
  - D. \$48,000

**Lifetime Capital Gains Deduction**

4. Which of the following statements with respect to the lifetime capital gains deduction is correct?
  - A. For purposes of calculating this deduction, the annual gains limit is reduced by the amount of the individual's CNIL.
  - B. It is always preferable to deduct net capital loss carry overs prior to making any use of the lifetime capital gains deduction
  - C. For 2016, the maximum deduction for qualified small business corporations is different than the maximum deduction for qualified family farm corporations.
  - D. The cumulative gains limit includes the annual gains limits for all previous years, but not for the current year.

*Tax Payable For Individuals Revisited - Multiple Choice***Tax On Split Income**

5. Elena is 12 years old. During 2016 she earns interest of \$10,500 on funds she inherited when her maternal grandfather died, as well as non-eligible dividends of \$15,300 received from a CCPC that is controlled by her father. Her only tax credits are the basic personal credit of \$1,721 and the dividend tax credit. What is the amount of her federal Tax Payable for 2016?
- A. \$656.
  - B. \$4,024.
  - C. \$2,303.
  - D. \$3,878.

**Tax Credits Revisited**

6. Mrs. Perry's total income consisted of \$9,000 in eligible dividends received from taxable Canadian corporations. Mrs. Perry's basic personal tax credit and dividend tax credits are sufficient to eliminate all of her Tax Payable. Because she receives these dividends, Mr. Perry is not able to claim a spousal tax credit. Mr. Perry's income is such that any additional income from the transfer would be taxed at the federal rate of 20.5 percent. By what amount would Mr. Perry's Tax Payable increase or decrease if Mrs. Perry's dividends were transferred to him?
- A. A decrease of \$1,040.
  - B. An increase of \$681.
  - C. An Increase of \$825.
  - D. A decrease of \$1,051.
7. Which of the following statements with respect to charitable donations is **NOT** correct?
- A. Amounts of eligible donations that are not used during the current year can be carried forward for up to 5 years.
  - B. When making a gift of non-depreciable capital property with a fair market value in excess of its capital cost, it is always advisable to elect the fair market value amount for the gift.
  - C. The basis for a charitable donations tax credit for the current year can never exceed 75 percent on the individual's Net Income For Tax Purposes.
  - D. Any capital gain arising on gifts of ecologically sensitive land are deemed to be nil.
8. For the year ending December 31, 2016, Liane Stanfield has Net Income For Tax Purposes of \$102,000. This includes foreign non-business income of \$30,000. This amount was before the withholding of taxes by the foreign government of \$6,000. In calculating her 2016 Taxable Income, she intends to deduct a net capital loss carry forward of \$10,000 and a \$30,000 non-capital loss carry forward. After applying her basic personal credit, the tax otherwise payable is \$7,579. What is the amount of Liane's foreign non-business tax credit?
- A. \$6,000.
  - B. \$2,471
  - C. \$4,500
  - D. \$3,667

## Retained From Previous Editions

### Taxable Income

9. Martin is worried about how much tax he will have to pay this year and he is looking for anything that he might have missed that will decrease his Taxable Income. All of the following could decrease his Taxable Income, with the exception of:
- a deduction for contributions to an RPP.
  - application of a net capital loss carryforward.
  - application of a non-capital loss carryforward.
  - a credit for a charitable donation.
10. Which of the following would reduce an individual's Taxable Income?
- A non-capital loss carried forward from a previous year.
  - A charitable donation carried forward from a previous year.
  - Adoption expenses.
  - Medical expenses.
11. Shelly is seeking your advice on how she can claim various deductions and credits. Which of the following items would reduce the amount of her Taxable Income?
- A net capital loss carried forward from a previous year.
  - A charitable donation.
  - Contributions to an RESP.
  - Childcare costs paid during the year.
- i, ii, and iv
  - ii and iv
  - i and iv
  - i, iii, and iv

### Lump-Sum Payments

12. Reuben Chechetto had to take his employer to court in 2016, to sue for wages owing to him over an 8 year period ending in 2016. In the 2016 taxation year, he receives a court settlement of \$80,000, or \$10,000 per year. In all years, Reuben had taxable income of \$60,000. What will the tax consequences be with respect to the \$80,000 in back wages received in 2016?
- Mr. Chechetto will have to report the full \$80,000 in additional wages in 2016.
  - As these funds were awarded through a court settlement, they are not taxable.
  - Mr. Chechetto can use a special relief mechanism in the *Income Tax Act* which will have the effect of spreading the lump-sum payment over a maximum period of 5 years.
  - Mr. Chechetto can use a special relief mechanism in the *Income Tax Act* which will have the effect of spreading the lump-sum payment over the 8 taxation years affected.

### Treatment Of Losses

13. Which of the following statements is correct with respect to the disposition of a valuable coin collection?
- If a loss occurs, it cannot be deducted against any source of income.
  - If a loss occurs, one-half of this amount can be applied against one-half of any capital gain.
  - If a gain occurs, one-half of this amount can be offset by allowable capital losses on any disposition of capital property.
  - If a gain occurs, it will not be taxed because this is personal use property.

*Tax Payable For Individuals Revisited - Multiple Choice*

14. As a part time employee, Derek earns \$20,000 per year of employment income. He recently started up his own business as a sole proprietorship. For the current year, his business revenues were \$12,000 and his business expenses were \$28,000. Derek has some investments that resulted in taxable dividend income of \$1,400 and incurred interest expense of \$2,000. Assuming this accounts for all of Derek's sources of income, what is his non-capital loss carry forward for the year?
- Nil.
  - \$600.
  - \$3,400.
  - \$16,000.
15. With respect to net capital loss balances, which of the following statements is **NOT** correct?
- In the year of death when such balances are deducted, the amount deducted will be based on the capital gains inclusion rate which applied in the year in which the loss was realized.
  - When such balances are carried back, they can be deducted only to the extent of taxable capital gains arising in the carry back period.
  - Such balances can be carried back three years.
  - Such balances can be carried forward for a maximum of 20 years.
16. Daria is a part time employee who recently started up her own business as a sole proprietorship. For the current year, she had the following sources of income and loss:
- |  |          |
|--|----------|
| Part time employment income                      | \$15,000 |
| Net business loss                                | 18,000   |
| Taxable (grossed up) dividend income             | 1,200    |
| Interest expense on loan to purchase investments | 2,000    |
| Capital gain                                     | 12,000   |
| Capital loss                                     | 16,000   |
- What is her non-capital loss carry forward for the year?
- \$3,000.
  - \$3,800.
  - \$5,800.
  - \$18,000.
17. For which of the following types of losses is it not necessary to segregate the loss by type in order to track the balance carried forward as a separate balance?
- Net capital losses.
  - Allowable Business Investment Losses.
  - Restricted farm losses
  - Business losses.
18. Under which set of circumstances would it be advisable to utilize a loss carry over to reduce taxable income to nil in the carry over year?
- When the taxpayer is carrying a loss back to a prior year, taxable income can be reduced to nil without negative consequences.
  - When the taxpayer is carrying a loss forward, taxable income can be reduced to nil without negative consequences.
  - Net capital losses are the only type of loss that should be used to reduce taxable income to nil in the carry over year.
  - It is never advisable to use a loss carry over to reduce taxable income to nil in the carry over year.

*Tax Payable For Individuals Revisited - Multiple Choice*

19. Which of the following types of losses cannot be carried forward for at least 20 years?
- A. Listed personal property losses.
  - B. Non-capital losses.
  - C. Net capital losses.
  - D. Restricted farm losses.
20. Tabari has income from employment of \$25,000 during the year. As well, he has a capital gain on Listed Personal Property of \$8,000 on the sale of a stamp collection, and a capital gain from the sale of some shares of \$6,000. Last year, he had a capital loss on Listed Personal Property of \$10,000 that he was unable to use and carried forward to the current year. What is his net income for tax purposes for the year, assuming that this accounts for all of his income for the year?
- A. \$27,000.
  - B. \$28,000.
  - C. \$31,000.
  - D. \$32,000.
21. Zina Chaburi has a full time job as a nurse in her local hospital. In her spare time she has a goat farming operation. The goat farm began in 2015, and resulted in a loss of \$10,000. She deducted the maximum allowable amount against her 2015 income. In 2016, most of the problems had been worked out, and Zina had a profit from the farm operation of \$5,000, as well as employment income of \$90,000. Determine Ms. Chaburi's taxable income for 2016.
- A. \$81,000.
  - B. \$88,750.
  - C. \$91,250.
  - D. \$95,000.

**Allowable Business Investment Losses**

22. Which of the following statements about Allowable Business Investment Losses is correct?
- A. They are losses that result from the disposition of shares or debt in a Canadian controlled public corporation.
  - B. They can only be deducted against business income.
  - C. If they are not used during the current year, they are added to the net capital loss balance.
  - D. If they are not used during the current year, they are added to the non-capital loss balance.
23. With respect to an Allowable Business Investment Loss, which of the following statements is **NOT** correct?
- A. An Allowable Business Investment loss can be deducted against any source of income.
  - B. If not used during the current year, an Allowable Business Investment Loss can only be applied against taxable capital gains in a carry forward or carry back period.
  - C. An Allowable Business Investment Loss results from the disposition of shares of a small business corporation.
  - D. An Allowable Business Investment Loss is the deductible portion of a Business Investment Loss.

*Tax Payable For Individuals Revisited - Multiple Choice***Lifetime Capital Gains Deduction**

24. Which of the following transactions could result in the taxpayer being able to make a lifetime capital gains deduction?
- A. An individual sells 100 percent of the shares of a CCPC that uses 85 percent of its assets in the operation of an active business.
  - B. An individual sells 15 percent of the shares of a CCPC that uses 95 percent of its assets in the operation of an active business.
  - C. A CCPC sells 100 percent of the shares of another CCPC that uses 100 percent of its assets in the operation of an active business.
  - D. An individual sells 25 percent of the shares of a CCPC that uses 30 percent of its assets to produce property income.
25. With respect to the lifetime capital gains deduction, which of the following statements is **NOT** correct?
- A. The deduction is only available to individuals.
  - B. The Cumulative Gains Limit is reduced by any CNIL balance at the end of the year.
  - C. The Annual Gains Limit is reduced by Allowable Business Investment Losses realized during the year.
  - D. The deduction is available on any disposition of shares or debt of a qualified small business corporation.
26. Which of the following is **NOT** a requirement for a business to qualify as a qualified small business corporation?
- A. At the time the shares are sold, the corporation must use all or substantially all of its assets for active business purposes in Canada.
  - B. More than 50 percent of the fair market value of the assets of the business must have been used for active business in the past 24 months.
  - C. The shares must not have been owned by a related individual in the past 24 months.
  - D. The shares must not have been owned by a non-related individual in the past 24 months.

**Ordering of Deductions and Losses**

27. Under ITA 111.1, the order in which individuals must deduct Division C items is specifically listed. Assuming a taxpayer is eligible to deduct all of the following amounts in computing Taxable Income, which one would be deducted last?
- A. Lifetime capital gains deduction.
  - B. Stock option deduction.
  - C. Loss carryovers.
  - D. Home relocation loan deduction.
28. With respect to the use of loss carryovers, which of the following statements is correct?
- A. Net-capital losses must always be used before any other type of loss.
  - B. Non-capital losses must be used last if a taxpayer has several different types of loss carryovers to choose from.
  - C. Within a particular type of loss, the oldest losses must be utilized first.
  - D. Claiming a non-capital loss carry forward will reduce the amount of the lifetime capital gains deduction available in the year.

*Tax Payable For Individuals Revisited - Multiple Choice***Tax On Split Income**

29. Which of the following statements with respect to the tax on split income (the "kiddie tax") is **NOT** correct?
- For purposes of this tax, a "specified individual" is anyone who has not reached the age of 17 years before the beginning of the year.
  - The tax is applied at a 33 percent rate to all of the income of a specified individual.
  - Split income includes taxable dividends received from private companies.
  - The only tax credits that can be applied against the Tax Payable on split income are dividend tax credits and foreign income tax credits.
30. Which of the following amounts are not considered "split income" of an individual under 18 years of age?
- Employment income from a private corporation.
  - Shareholder benefits received from a private corporation.
  - Eligible dividends received from a private corporation.
  - Non-eligible dividends received from a private corporation.
31. Katrina is 17 years old, and she receives a non-eligible dividend of \$12,000 from a private company controlled by her mother. In addition, she has interest income of \$6,000 on funds that she inherited when her grandmother passed away. Her only tax credits are the basic personal credit and the dividend tax credit. How much is her federal tax payable for the year?
- nil
  - \$1,435.
  - \$2,335
  - \$3,156.

**Tax Credits Revisited****(Dividends To Spouse, Charitable Donations, Foreign Tax Credits)**

32. Mrs. Mantz receives eligible dividend income of \$12,000 every year. Her spouse is unable to utilize the spousal credit because of the dividends received by Mrs. Mantz. She is considering transferring the dividends to her spouse which will then enable him to claim some or all of the spousal credit. Under what circumstances would this most likely be tax advantageous?
- If Mrs. Mantz is receiving OAS.
  - If Mr. Mantz is in the 15 percent federal tax bracket.
  - If Mr. Mantz is in the 33 percent federal tax bracket.
  - If Mr. Mantz can claim the full spousal credit.
33. An individual has Net Income For Tax Purposes of \$147,500. During the current year, the individual donates a depreciable capital asset with a fair market value of \$300,000. The capital cost of this asset is \$225,000 and it has a UCC \$147,000. It is the only asset in its CCA class and no additions are made subsequent to the gift. If he elects to have the donation valued at its fair market value, what is the maximum amount that this individual can claim as the basis for his charitable donations tax credit for the current year?
- \$300,000
  - \$110,625
  - \$139,500
  - \$148,875

*Tax Payable For Individuals Revisited - Multiple Choice*

34. Which of the following amounts would **NOT** be considered to be a charitable donation for purposes of the charitable donations tax credit?
- A. A donation to a charitable organization outside of Canada to which the taxpayer's province of residence has also made a donation.
  - B. A donation to her Majesty in right of Canada.
  - C. A gift of land to a Canadian municipality that has been certified by the Minister of the Environment to be ecologically sensitive land.
  - D. A gift to a registered Canadian athletic association.
35. Assume that any foreign income is taxed in the foreign jurisdiction. Which one of the following types of foreign income generates foreign tax credits that may be applied to other taxation years?
- A. Business income only.
  - B. Capital gains only.
  - C. Employment income only.
  - D. Investment income only.
36. Assuming that foreign income is taxed in the foreign jurisdiction, which of the following types of income results in foreign tax withholdings that could generate both a tax credit and a tax deduction for individuals?
- A. Foreign business income.
  - B. Foreign employment income.
  - C. Foreign interest income.
  - D. All foreign income.
37. With respect to the Foreign Non-Business Income Tax Credit and the Foreign Business Income Tax Credit for individuals, which of the following statements is correct?
- A. The Foreign Business Income Tax Credit is limited to 15% of the foreign business income.
  - B. The Foreign Non-Business Income Tax Credit is limited to 15% of the foreign non-business income.
  - C. The Foreign Business Income Tax Credit cannot exceed tax otherwise payable for the year.
  - D. Any unused Foreign Non-Business Income Tax Credit can be carried forward for 10 years and carried back 3 years.
38. Djohn Django had all of the following income taxed in a foreign jurisdiction in the current year. Which type of foreign income can generate a foreign tax credit that can be carried forward and applied against Canadian income tax payable in other taxation years?
- A. Employment income from a foreign employer
  - B. Property income on dividends from foreign stocks
  - C. Business income from a contract with a foreign entity
  - D. Taxable capital gains on the sale of foreign stocks

**Alternative Minimum Tax**

39. In the calculation of Adjusted Taxable Income in the alternative minimum tax calculation, which of the following are not considered tax preference items?
- A. Losses arising through the deduction of CCA on Certified Canadian Films.
  - B. Dividend tax credits.
  - C. Employee stock option deductions.
  - D. Limited partnership losses.

*Tax Payable For Individuals Revisited - Multiple Choice*

40. Which one of the following would **NOT** affect the calculation of the alternative minimum tax?
- A. Stock options not yet exercised.
  - B. The deduction of an Allowable Business Investment Loss.
  - C. A taxable capital gain resulting from the sale of a cottage.
  - D. Dividends received from a taxable Canadian corporation.

**TIF PROBLEM ELEVEN - 4****Tax Payable For Individuals Revisited - Exam Exercises****Exam Exercise Subject Listing For Chapter 11**

<b>Number</b>	<b>Subject</b>
1	Listed Personal Property Losses
2	Listed Personal Property Losses
3	Loss Carry Overs
4	Loss Carry Overs
5	Loss Carry Overs
6	Loss Carry Overs
7	Net Capital Losses At Death
8	Net Capital Losses At Death
9	ABILs
10	ABILs
11	Farm Losses
12	Lifetime Capital Gains Deduction
13	Ordering Of Losses
14	Ordering Of Losses
15	Tax On Split Income
16	Transfer Of Dividends To A Spouse
17	Donation Of Non-Depreciable Property
18	Donation Of Non-Depreciable Property
19	Donation Of Depreciable Property
20	Donation Of Depreciable Property
21	Foreign Tax Credit
22	Foreign Tax Credit
23	Alternative Minimum Tax
24	Alternative Minimum Tax

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

During 2015, Ms. Jessica Michaels was unemployed and had no income of any kind. In order to survive, she sold a painting on December 1, 2015 for \$78,000. This painting had been left to Ms. Michaels by her father and, at the time of his death, it had a fair market value of \$102,000.

During 2016, Ms. Michaels finds a job and has employment income of \$69,000. In addition, during June, she sells a second painting for \$7,000. She had purchased this painting several years ago for \$1,100. She has no other sources of income in 2016.

Determine Ms. Michaels' Net Income For Tax Purposes and Taxable Income for 2016. Indicate the amount and type of any losses available for carry forward at the end of the year. Assume the December 1, 2015 sale had been of publicly traded shares instead of a painting. How would this change your solution?

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

During 2015, Jude Legal sold an important piece of jewelry for \$120,000. He had paid \$150,000 for this item several years ago. In 2016, he sells a block of publicly traded shares for \$125,000. The adjusted cost base of these shares was \$72,000. He has no other sources of income in either 2015 or 2016.

Determine Jude's Net Income For Tax Purposes and Taxable Income for 2016. Indicate the amount and type of any losses available for carry forward at the end of that year. If the 2015 sale had been of publicly traded shares instead of jewelry, how would the results for 2016 be changed?

**Exam Exercise Eleven - 3 (Loss Carry Overs)**

Mr. John Klaus has an unincorporated business with a December 31 year end. During 2015, its first year of operation, the business has net business income of \$19,000 and a taxable capital gain of \$3,000 [(1/2)(\$6,000)]. The following amounts relate to the year ending December 31, 2016:

Business Loss	(\$56,000)
Capital Gains	3,200
Capital Losses	( 9,800)

Mr. Klaus has no other source of income or deductions in either year. Assume that he wishes to minimize his net capital and non-capital loss carry overs at the end of 2016, without regard to his ability to claim his tax credits for the preceding year (2015). Calculate his Net Income For Tax Purposes and Taxable Income for 2015 and 2016 and any amended amounts for 2015. Indicate the amount and type of any losses available for carry forward at the end of 2016.

**Exam Exercise Eleven - 4 (Loss Carry Overs)**

Maria Shank operates an unincorporated business which, during the taxation year ending December 31, 2015 has net business income of \$28,000 and a taxable capital gain of \$6,500 [(1/2)(\$13,000)].

In 2016, her business has a net loss of \$85,000. In addition to this loss, a capital asset disposition results in an allowable capital loss of \$10,800.

Maria has no other sources of income or deductions in either year. Assume that she wishes to minimize her net capital and non-capital loss carry overs at the end of 2016, without regard to her ability to claim her tax credits for 2015. Calculate her Net Income For Tax Purposes and Taxable Income for 2015 and 2016 and any amended amounts for 2015. Indicate the amount and type of any losses available for carry forward at the end of 2016.

**Exam Exercise Eleven - 5 (Loss Carry Overs)**

Ms. Jean Claus has an unincorporated business with a December 31 year end. During 2015, its first year of operation, the business has net business income of \$45,000. The business also had an allowable capital loss during the year of \$5,250 [(1/2)(\$10,500)], which could not be deducted. The following amounts relate to the year ending December 31, 2016:

Business Loss	(\$83,000)
Capital Gains	12,600
Capital Losses	( 6,300)

Ms. Claus has no other source of income or deductions in either year and does not anticipate realizing capital gains in the foreseeable future. Assume she wishes to minimize her net capital and non-capital loss carry overs at the end of 2016, without regard to her ability to claim her tax credits for the preceding year (2015). Calculate her Net Income For Tax Purposes and Taxable Income for 2015 and 2016 and any amended amounts for 2015. Indicate the amount and type of any losses available for carry forward at the end of 2016.

**Exam Exercise Eleven - 6 (Loss Carry Overs)**

Ms. Dora McLean operates an unincorporated business. During the taxation year ending December 31, 2015, the business had net business income of \$95,000. Dora also had an allowable capital loss of \$9,250 [(1/2)(\$18,500)] that could not be deducted.

Unfortunately, in 2016, the business had a business loss of \$123,000. Offsetting this was a net taxable capital gain of \$7,200 [(1/2)(\$14,400)]. Dora has no other sources of income or deductions in either year. She does not anticipate realizing any additional capital gains in the foreseeable future.

Assume that Dora wishes to minimize her net capital and non-capital loss carry overs at the end of 2016, without regard to her ability to claim her tax credits for the preceding year (2015). Calculate her Net Income For Tax Purposes and Taxable Income for 2015 and 2016 and any amended amounts for 2015. Indicate the amount and type of any losses available for carry forward at the end of 2016.

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

Ms. Tanya Forester dies during August, 2016. At the time of her death, she has a net capital loss from 1996 of \$31,500 [(3/4)(\$42,000)]. As the result of a deemed disposition at her death of her art collection, she has a taxable capital gain of \$15,500. Ms. Forester has made no previous use of the lifetime capital gains deduction. Her 2016 employment income in the period prior to her death was \$47,000. Describe the tax treatment of these items in her final tax return.

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

Barton Foster dies during July, 2016. In 1993 he had a capital loss of \$54,000. As he has had no capital gains since that time, he has not been able to deduct any of this amount. This means that he has a net capital loss carry forward of \$40,500 [(3/4)(\$54,000)].

His death results in a deemed disposition of his portfolio of public company shares which creates a capital gain of \$32,000. Mr. Foster has made no previous use of the lifetime capital gains deduction. In addition, prior to his death, he has employment income of \$61,000.

Describe the tax treatment of these items in his final return.

**Exam Exercise Eleven - 9 (ABILs)**

During 2015, Mrs. Lacinda Brown used her lifetime capital gains deduction to eliminate a taxable capital gain of \$15,000  $[(1/2)(\$30,000)]$ . During 2016, she has capital gains on publicly traded securities of \$21,000, and a loss of \$47,000 on the disposition of shares of a small business corporation. Her employment income for 2016 is over \$250,000. Determine the amount of the Allowable Business Investment Loss that can be deducted in 2016, as well as the amount and type of any losses available for carry over at the end of the year.

**Exam Exercise Eleven - 10 (ABILs)**

For many years, Jasmine Ho has had employment income in excess of \$300,000. This will also be the case in 2016. During 2016, she has a \$38,000 loss on the disposition of shares of a small business corporation. Also during this year, she has capital gains on publicly traded securities of \$5,000. The only other year in which she experiences capital gains was 2008. In that year she had a capital gain of \$8,000 on the sale of shares of a qualified farm property. She eliminated all of this gain with the lifetime capital gains deduction. Determine the amount of the Allowable Business Investment Loss that can be deducted in 2016, as well as the amount and type of any losses available for carry over at the end of the year.

**Exam Exercise Eleven - 11 (Farm Losses)**

Despite having a full time teaching position at a Canadian university, Bob Fife has considerable amounts of free time. Given this, he has started a farming operation on a tract of land near the university where he teaches. In 2015, he had a loss on the farming operation of \$24,000. He deducted the maximum possible amount in that year.

In 2016, he has employment income of \$105,000 and the farming operation produces additional income in the amount of \$6,000. Determine Bob's minimum 2016 Net Income For Tax Purposes and Taxable Income. Also, determine the amount and type of any losses available for carry forward at the end of 2016.

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

Prior to 2016, Ms. Henny Close has had two capital gains and one capital loss. In 2011, she had a capital gain of \$18,000 and in 2013, she had a capital gain of \$54,000. Both of these gains were on dispositions of shares in a qualified small business corporation. Given this, she used her ITA 110.6 lifetime capital gains deduction to eliminate the taxable amount of these gains. She has a net capital loss carry forward balance of \$30,000. This resulted from a 2014 capital loss of \$60,000. She intends to deduct this carry forward in 2016. She has never experienced a Business Investment Loss.

During 2016, she has a \$748,000 capital gain on the sale of shares in a qualified small business corporation. Ms. Close has a CNIL balance on December 31, 2016 of \$23,000. Determine Ms. Close's maximum lifetime capital gains deduction for 2016. Provide all of the calculations required to determine the maximum ITA 110.6 deduction.

*Tax Payable For Individuals Revisited - Exam Exercises***Exam Exercise Eleven - 13 (Ordering Of Losses)**

At the beginning of 2016, Joanne Chance had the following loss carry forwards available:

Restricted Farm Losses	\$ 7,200
Non-Capital Losses	41,000
Net Capital Losses [(1/2)(\$50,000)]	25,000

During 2016, she had the following amounts of income:

Taxable Capital Gains	\$ 10,500
Business Income	14,200
Employment Income	61,000
Farm Income	2,950

Determine Joanne's Net Income For Tax Purposes, as well as her minimum Taxable Income for 2016. Indicate the amount and type of any losses available for carry forward at the end of the year.

**Exam Exercise Eleven - 14 (Ordering Of Losses)**

At the beginning of 2016, Cindy Burke had the following loss carry forwards available:

Non-Capital Losses	\$25,000
Restricted Farm Losses	4,000
Net Capital Losses [(1/2)(\$64,000)]	32,000

During the taxation year ending December 31, 2016, she recorded the following amounts of income:

Farm Income	\$ 2,500
Taxable Capital Gains	21,000
Business Income	74,000

Determine Cindy's Net Income For Tax Purposes, as well as her minimum Taxable Income for 2016. Indicate the amount and type of any losses available for carry forward at the end of the year.

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

During 2016, Harriet Humber, who is 15 years old, receives non-eligible dividends of \$13,000 from a private corporation controlled by her father. In addition, she has income of \$13,100 from her modeling contracts. Assume her only tax credits are the basic personal credit and the dividend tax credit. Determine Harriet's federal Tax Payable for 2016.

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

Mrs. Mary Senton is 42 years old and has over \$250,000 in 2016 Taxable Income. Her husband's only source of 2016 income is \$9,000 (grossed up amount of \$12,420) in eligible dividends received from taxable Canadian corporations. In terms of federal Tax Payable, would Mrs. Senton benefit from the use of the ITA 82(3) election to include the dividends received by her spouse in her Net Income For Tax Purposes? Justify your conclusion.

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

Ms. Katrina Wave owns a painting that she purchased many years ago for \$22,000. Its current fair market value is \$132,500. During 2016, she gifts the painting to the Renfrew Art Gallery. As the Gallery is a registered Canadian charity, it provides Ms. Wave with a tax receipt for the fair market value of \$132,500. Before consideration of any income resulting from this gift, Ms. Wave's only other income is investment income of \$12,500. She has no tax credits other than her basic personal credit and the charitable donations credit resulting from the gift of the painting.

**Required:** Determine Ms. Wave's:

- 2016 Net Income For Tax Purposes;
- her maximum federal charitable donations tax credit for 2016;
- the amount of the donation she should claim in 2016 in order to reduce her federal Tax Payable to nil; and
- the amount of contributions that can be carried forward to subsequent years, assuming that she claims the amount of contributions that would reduce her Tax Payable to nil.

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

Lara Rand owns a tract of land that she had acquired many years ago for \$18,000. During 2016, she gifts the land to a registered Canadian charity. At the time of the gift, the fair market value of the land is estimated to be \$84,000, with the charity issuing a tax receipt for this amount. In addition to the capital gain resulting from this gift, Lara has 2016 rental income of \$23,000. She has no tax credits other than her basic personal credit and the charitable donations credit resulting from the gift of the land.

**Required:** Determine Ms. Rand's:

- 2016 Net Income For Tax Purposes;
- her maximum federal charitable donations tax credit for 2016;
- the amount of the donation she should claim in 2016 in order to reduce her federal Tax Payable to nil; and
- the amount of contributions that can be carried forward to subsequent years, assuming that she claims the amount of contributions that would reduce her Tax Payable to nil.

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

Mr. Gerald Deveau owns a rental property that, during 2016, he gave to a charity to house its continuing operations. The building had originally cost Mr. Deveau \$172,000, of which \$34,000 was allocated to the land and \$138,000 was allocated to the building. At the time of the gift, the UCC of the building is \$43,000, and the fair market value of the property is \$346,000, including \$86,000 for the land and \$260,000 for the building. The charity issues a tax receipt for \$346,000. Before consideration of any income resulting from this gift, Mr. Deveau's only other income is net rental income of \$8,300. His only tax credits are his basic personal credit and the charitable donations credit resulting from the gift of the building.

**Required:** Determine Mr. Deveau's:

- 2016 Net Income For Tax Purposes;
- his maximum federal charitable donations tax credit for 2016;
- the amount of the donations he should claim in 2016 in order to reduce his federal Tax Payable to nil; and
- the amount of contributions that can be carried forward to subsequent years, assuming that he claims the amount of contributions that would reduce his Tax Payable to nil.

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

During 2016, Victor Flood donates a rental property to a registered Canadian charity. The property had a cost of \$226,000, including a value for the land of \$50,000 and a value for the building of \$176,000. At the time of the gift, the estimated fair market value of the property is \$396,000, with the value of the land unchanged at \$50,000 and the value of the building at \$346,000. The UCC of the building is \$110,000 at the time of transfer. The charity issues a receipt for \$396,000. Other than the income generated by the gift, Victor's only other 2016 income is net rental income of \$16,000. His only 2016 tax credits are his basic personal credit and the charitable donations credit resulting from the gift.

**Required:** Determine Victor's:

- 2016 Net Income For Tax Purposes;
- his maximum federal charitable donations tax credit for 2016;
- the amount of the donations he should claim in 2016 in order to reduce his federal Tax Payable to nil; and
- the amount of contributions that can be carried forward to subsequent years, assuming that he claims the amount of contributions that would reduce his Tax Payable to nil.

**Exam Exercise Eleven - 21 (Foreign Tax Credit)**

During 2016, Kevin Fung has Net Income For Tax Purposes of \$56,500, a figure that includes \$3,900 of foreign non-business income. The foreign jurisdiction withheld 13 percent of this amount, resulting in a net receipt of \$3,393. In calculating Taxable Income, he deducts a \$5,000 non-capital loss carry forward and a \$3,200 net capital loss carry forward, resulting in a figure of \$48,300. His only tax credits are the basic personal credit and the credit for foreign tax paid. What is the amount of his foreign non-business income tax credit for 2016? A calculation of federal Tax Payable is NOT required.

**Exam Exercise Eleven - 22 (Foreign Tax Credit)**

During 2016, Andy Loon earned \$4,500 in foreign non-business income. The foreign jurisdiction withheld 20 percent of this amount, resulting in a net receipt of \$3,600. His only other source of income in 2016 is a taxable capital gain of \$38,000. His only deduction in the determination of Taxable Income is a \$26,000 net capital loss carry forward. His only tax credits are the basic personal credit and the credit for foreign tax paid. Determine Mr. Loon's 2016 Net Income For Tax Purposes, his 2016 Taxable Income, and his 2016 federal Tax Payable.

**Exam Exercise Eleven - 23 (Alternative Minimum Tax)**

During 2016, Mr. Glenn Leigh has Net Income For Tax Purposes of \$144,288. This amount is made up of taxable capital gains of \$120,000 and taxable eligible dividends of \$24,288 [(138%)(\$17,600)]. As the taxable capital gain was on a disposition of shares in a qualified small business corporation, he reduced his Taxable Income to \$24,288 through the use of the lifetime capital gains deduction. His only tax credits are the basic personal credit and the dividend tax credit. Determine whether Mr. Leigh would have a liability for the federal alternative minimum tax and, if so, the total amount of such tax.

**Exam Exercise Eleven - 24 (Alternative Minimum Tax)**

During 2016, Shelly Large sold shares in a qualified small business corporation for \$580,000 resulting in a taxable capital gain of \$200,000. She intends to deduct the taxable amount of this gain under the provisions of the lifetime capital gains deduction legislation. Her only other source of income during the year was eligible dividends of \$23,000 (taxable amount \$31,740). Her only tax credits are the basic personal credit and the dividend tax credit. Determine whether Ms. Large would have a liability for the federal alternative minimum tax and, if so, the total amount of such tax.

**TIF PROBLEM ELEVEN - 5A****Tax Payable For Individuals Revisited - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 11, “Taxable Income And Tax Payable For Individuals Revisited”.

- A. Annual Gains Limit
- B. Business Investment Loss
- C. Lifetime Capital Gains Deduction
- D. Net Capital Loss
- E. Purification Of A Small Business Corporation
- F. Qualified Small Business Corporation
- G. Small Business Corporation
- H. Split Income

The following list contains ten potential definitions for the preceding key terms.

1. A small business corporation that, at the time of its disposition, has been owned by no one other than the taxpayer or a related party during the preceding 24 months, and during that 24 month period, more than 50 percent of the fair market value of its assets were used in an active business carried on primarily in Canada.
2. A loss resulting from the disposition of shares or debt of a small business corporation.
3. For individuals, the sum of employment losses, business losses, property losses and net capital losses deducted, less income as calculated under ITA 3(c).
4. Taxable capital gains on qualified assets that have been realized since 1984, less the sum of allowable capital losses and net capital loss carry overs deducted after 1984, plus allowable business investment losses realized after 1984, capital gains deductions claimed in previous taxation years, and the cumulative net investment loss at the end of the year.
5. Taxable capital gains for the current year on qualified assets, less the sum of allowable capital losses and net capital loss carry overs deducted during the current year, plus allowable business investment losses realized during the current year.
6. Certain types of income received by a specified individual from non-arm’s length sources that will be taxed at the maximum federal rate of 33 percent.
7. A deduction in the calculation of the taxable income of an individual that permits the deduction of a cumulative lifetime amount of up to \$824,176 in capital gains resulting from the disposition of shares of qualified small business corporation shares, or capital gains of up to \$1,000,000 on dispositions of a qualified farm or qualified fishing property.
8. The excess of allowable capital losses over taxable capital gains for the current year.
9. A corporation that is a Canadian controlled private corporation that uses all or substantially all (90 percent or more) of the fair market value of its assets in an active business that is carried on primarily (more than 50 percent) in Canada.

*Tax Payable For Individuals Revisited - Key Term Matching (Easy)*

10. A process of disposing of corporate assets that are not being used to produce active business income, so that the corporation meets the 90 percent of assets test required to qualify as a small business corporation.
11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM ELEVEN - 5B****Tax Payable For Individuals Revisited - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 11, “Taxable Income And Tax Payable For Individuals Revisited”.

- A. Annual Gains Limit
- B. Business Investment Loss
- C. Lifetime Capital Gains Deduction
- D. Net Capital Loss
- E. Purification Of A Small Business Corporation
- F. Qualified Small Business Corporation
- G. Small Business Corporation
- H. Split Income

The following list contains 14 potential definitions for the preceding key terms.

1. The excess of allowable capital losses over capital gains for the current year.
2. A small business corporation that, at the time of its disposition, has been owned by no one other than the taxpayer or a related party during the preceding 24 months, and during that 24 month period, more than 50 percent of the fair market value of its assets were used in an active business carried on primarily in Canada.
3. A loss resulting from the disposition of shares or debt of a small business corporation.
4. For individuals, the sum of employment losses, business losses, property losses and net capital losses deducted, less income as calculated under ITA 3(c).
5. Certain types of income received by children from their parents that will be taxed at the maximum federal rate of 33 percent.
6. Taxable capital gains on qualified assets that have been realized since 1984, less the sum of allowable capital losses and net capital loss carry overs deducted after 1984, plus allowable business investment losses realized after 1984, capital gains deductions claimed in previous taxation years, and the cumulative net investment loss at the end of the year.
7. Taxable capital gains for the current year on qualified assets, less the sum of allowable capital losses and net capital loss carry overs deducted during the current year, plus allowable business investment losses realized during the current year.
8. Certain types of income received by a specified individual from non-arm’s length sources that will be taxed at the maximum federal rate of 33 percent.
9. A corporation that, at the time of its disposition, has been owned by no one other than the taxpayer or a related party during the preceding 24 months, and during that 24 month period, more than 50 percent of the fair market value of its assets were used in an active business carried on primarily in Canada.

*Tax Payable For Individuals Revisited - Key Term Matching (Moderate)*

10. A deduction in the calculation of the taxable income of an individual that permits the deduction of a cumulative lifetime amount of up to \$824,176 in capital gains resulting from the disposition of shares of qualified small business corporation shares, or capital gains of up to \$1,000,000 on dispositions of a qualified farm or qualified fishing property.
11. The excess of allowable capital losses over taxable capital gains for the current year.
12. A corporation that is a Canadian controlled private corporation that uses all or substantially all (90 percent or more) of the fair market value of its assets in an active business that is carried on primarily (more than 50 percent) in Canada.
13. A process of disposing of corporate assets that are not being used to produce active business income, so that the corporation meets the 90 percent of assets test required to qualify as a small business corporation.
14. A loss resulting from the disposition of shares or debt of a qualified small business corporation.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (1). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM ELEVEN - 6**

### **Losses Carry Overs - Individuals**

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Over a four year period ending on December 31, 2016, Mr. Bob Barkin had the following financial data:

	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
Property Income (Loss)	\$27,600	(\$22,250)	\$44,100	(\$30,800)
Farming Income (Loss)	( 12,200)	2,320	3,840	( 2,400)
Taxable (Grossed-Up) Dividends	3,864	5,106	7,452	10,902
Capital Gains	1,800	3,000	6,000	6,700
Capital Losses	( 9,200)	Nil	Nil	( 21,300)

Because of the nature of his farming activities, Mr. Barkin's farm losses are restricted.

When he has a choice, he would like to deduct the maximum amount of his net capital loss carry overs and carry back any losses to the earliest possible year. None of Mr. Barkin's losses can be carried back before 2013 as he has had no income in the previous three years.

Assume that Mr. Barkin requires \$18,500 in Taxable Income in each year to fully utilize his tax credits. As a result, Mr. Barkin's Taxable Income should not be reduced below \$18,500 when applying loss carry over amounts.

**Required:** Calculate Mr. Barkin's minimum Net Income For Tax Purposes 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.

**TIF PROBLEM ELEVEN - 7****Allowable Business Investment Losses**

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During 2013, Mr. Larry Atkins invested \$275,000 to acquire 100 percent of the common shares of a corporation involved in the production of plastic containers. The company was a Canadian controlled private corporation with a fiscal year ending on January 31. All of its assets were used to produce active business income in Canada.

In 2013 and 2014, the company operated successfully, but did not pay any dividends. In 2015, it began to experience serious financial difficulties. In 2016, the company shut down and all of the assets were sold. After the claims of the creditors were settled, Mr. Atkins' shares were canceled and he received a final payment of \$65,000.

Other financial data for Mr. Atkins for the years ending December 31, 2015 and December 31, 2016, is as follows:

	2015	2016
Net rental income	\$36,870	\$41,200
Interest Income	5,250	5,650
Basic personal tax credit amount	11,327	11,474

The only tax credit available to Mr. Atkins in either year is the basic personal credit. Mr. Atkins had no income for 2013 and 2014. At the beginning of 2014, he did not have any loss carry forwards from previous years.

Mr. Atkins has never utilized his lifetime capital gains deduction.

**Required:** Determine Mr. Atkins' optimum Taxable Income for the years ending December 31, 2015 and December 31, 2016. In your solution, consider the effect of the basic personal credit. Indicate any loss carry over that is present at the end of either year, and the rules applicable to claiming the loss carry over.

**TIF PROBLEM ELEVEN - 8****ABILs And Lifetime Capital Gains Deduction**

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At the beginning of 2016, Mr. Andy Barkin had a net capital loss of \$13,700 [(1/2)(\$27,400)].

During 2016, Mr. Barkin had net employment income of \$115,000. Additional information for the year 2016 is as follows:

- Mr. Barkin sold shares of a qualified small business corporation for proceeds of \$328,000. The adjusted cost base of these shares was \$153,000. Selling costs were \$2,000.
- At the end of the year, Mr. Barkin had a Cumulative Net Investment Loss balance of \$4,800.
- Mr. Barkin sold shares of a small business corporation that was not qualified for \$55,000. These shares had an adjusted cost base of \$228,000. Selling costs were \$1,000.

In 2005, Mr. Barkin had a capital gain of \$38,000. A further capital gain of \$21,000 was realized in 2008. As both of these gains involved dispositions of qualified property, he deducted each amount in full under the provisions of ITA 110.6, the lifetime capital gains deduction provision. Mr. Barkin has not deducted any other amounts under ITA 110.6 in the years prior to 2016.

Mr. Barkin would prefer to make maximum use of his lifetime capital gains deduction prior to deducting any net capital loss carry forwards.

**Required:** Calculate Mr. Barkin's minimum Net Income For Tax Purposes and Taxable Income for 2016. Provide all of the calculations required to determine the maximum ITA 110.6 deduction.

**TIF PROBLEM ELEVEN - 9****Transfer Of Credits And Pension Income Splitting**

Mr. and Mrs. Hanson have been retired for several years. They are both in their early seventies, 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, 2016 are as follows:

	<b>Mr. Hanson</b>	<b>Mrs. Hanson</b>
Old Age Security Benefits	\$ 7,000	\$7,000
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

\*Because of their regular contributions to registered charities, the Hansons are not eligible for the first-time donor's super credit.

**Required:**

- A. Assume that Mr. and Mrs. Hanson do not elect to use the pension income splitting provisions. Determine the Taxable Income for both Mr. and Mrs. Hanson, and the maximum federal tax credits that will be available to Mr. Hanson for the 2016 taxation year. Also indicate the amount and types of any loss carry overs that would be available to Mr. and Mrs. Hanson at the end of 2016.
- 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.)

## TIF PROBLEM ELEVEN -10

### Alternative Minimum Tax

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The following two independent cases involve taxpayers who might be subject to the alternative minimum tax in the 2016 taxation year.

**Case One** Serge Lawson has made the following estimates of the various types of income and deductions that he anticipates for the year ending December 31, 2016.

Net Rental Income	\$73,100
Eligible Dividends Received	14,000
RRSP Contributions	22,000

Prior to 2016, Serge has never managed to have enough funds to make any RRSP contributions, leaving him with nearly \$100,000 in unused deduction room. However, in 2016, his gambling habit finally pays off, providing sufficient winnings to make a \$22,000 contribution. He plans to deduct the full amount in 2016.

**Case Two** Sarah Bonito has made the following estimates of the various types of income and deductions that she anticipates for the year ending December 31, 2016.

Eligible Dividends Received	\$ 26,000
Net Taxable Capital Gains	263,000
Lifetime Capital Gains Deduction Claimed	260,000

In both Cases, assume the only tax credits available are the basic personal tax credit and the dividend tax credit related to any dividends received.

**Required:** For both Cases, determine whether there is a liability for alternative minimum tax and, if so, the total amount of such tax. In addition, calculate any related carry forwards available.

## **TIF PROBLEM ELEVEN -11**

### **Alternative Minimum Tax**

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Walter, Wendel, and Winston Lawson are brothers. For 2016, they are all concerned about the impact of the alternative minimum tax on the amount of tax they will have to pay. In order to help them prepare for any additional tax payments that they may encounter, they have provided you with the following estimates of the various types of income and deductions they expect to record for 2016.

	<b>Walter</b>	<b>Wendel</b>	<b>Winston</b>
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
Lifetime Capital Gains Deduction Claimed	36,400	Nil	221,500
Retiring Allowance	Nil	35,000	Nil
RRSP Contributions	Nil	35,000	Nil

As Wendel had worked for his present employer for over 49 years, he was eligible for a tax free rollover of the entire retiring allowance to an RRSP.

All dispositions resulting in taxable capital gains were of shares of qualified small business corporations.

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 the presence of tax credits for EI and CPP contributions, as well as the Canada Employment credit.

**Required:** Calculate the minimum regular 2016 federal Tax Payable for each of the three Lawsons, as well as the alternative minimum tax amount.

## TIF PROBLEM ELEVEN - 12

### Comprehensive Tax Payable

#### (Including Death And Pension Income Splitting)

Mr. Wally Bronson is 67 years old and has been retired for several years. His spouse, Melissa, is 62 and has been blind for the last ten years. They live in Ottawa. Mr. Bronson receives pension income of \$83,000 in 2016 from his employer's registered pension plan. Due to his high income in the last few years, Mr. Bronson has not applied for OAS benefits. However, he has applied for Canada Pension Plan payments and received \$10,680 in CPP benefits in 2016.

Melissa has no income and none of the family's investments are in her name.

Wally and Melissa have two children. Their son, Jerome, is 42 years old and their daughter, Jerri, is 38 years old. Neither child is dependent on Mr. Bronson. While Jerome has no children, Jerri has a 12 year old daughter, Brenda.

In December, 2015, Mr. Bronson is diagnosed with terminal cancer, with the doctor indicating that he probably has about 12 months to live. To this point, Mr. Bronson had not dealt with the prospect of death and, beyond the preparation of a fairly simple will which left all of his assets to Melissa, had done little in the way of estate planning. Given his current state of health, he has decided to undertake a number of transactions in order to minimize the tax consequences of his death.

He is particularly concerned with the fact that, in the province in which he lives, probate fees equal to 1.5 percent of the fair market value of almost all of the assets that are transferred in his will. Given this, he intends to transfer a significant amount of his assets into the hands of others prior to his death. At this time he also revises his will, leaving some property to his two children with the remainder going to his wife.

Mr. Bronson owns two tracts of vacant land. Plot A has a cost of \$125,000 and a fair market value of \$150,000. Plot B has a cost of \$175,000 and a fair market value of \$210,000. While he had intended to develop rental properties on these sites, he has decided that this is no longer feasible and the properties should be sold. Because his younger brother, Phil, is in a low tax bracket, during 2016, he sells Plot A to him, with the only consideration being a note for \$50,000 which is paid on December 1, 2016. In contrast, his older brother, Gary, is very wealthy and is in the highest tax bracket. In gratitude for Wally's help during a family crisis, Gary offers to buy Plot B for \$250,000 in cash. Wally accepts the offer, thinking of Melissa.

On January 1, 2016, Mr. Bronson acquires units in the YP Real Estate Income Trust at a cost of \$300,000. These units distribute \$800 per month on the 25th of each month. This distribution represents only rental income and does not include dividends, capital gains, or a return of capital. On February 1, 2016, after receiving the January payment of \$800, Mr. Bronson gifts all of these units to his granddaughter, Brenda. At this time, the units have a fair market value of \$310,000.

Mr. Bronson owns a large block of Baron Inc. shares. He acquired 4,000 shares of this widely held public company at \$50 per share and acquired an additional 8,000 shares at \$65 per share. On March 1, 2016, he gifts 1,500 shares to both of his children and an additional 1,500 shares to his wife. At this time, the shares are trading at \$68 per share. On July 1, 2016, Baron Inc. pays an eligible dividend of \$1.50 per share.

Mr. Bronson owns three identical units in a condominium building. Each unit cost \$300,000 nine years ago and, on January 1, 2016, each had a separate class UCC of \$205,000. The value of the land is nil as the building is on land leased from the National Capital Commission for 100 years. During 2016, these units produced net rental income, before consideration of CCA, of \$93,750.

On December 31, 2016, Mr. Bronson dies peacefully in his home. On this date he has the following assets:

**Baron Inc. Shares** The 7,500 shares that remain in Mr. Baron's name on this date are trading at \$70 per share. Mr. Bronson's will leaves all of these shares to his spouse, Melissa.

**Condominium Units** In his will, Mr. Baron has left one of these units to each of his two children, with the remaining unit going to his spouse. On the date of Mr. Bronson's death, each of these units has a fair market value of \$420,000.

**Principal Residence** Mr. Bronson and his wife have lived in the same home for 20 years. The house is owned by Mr. Bronson. It cost \$145,000 and has a current market value of \$562,000. Mr. Bronson's will leaves this property to his spouse.

During 2016, medical expenses for Mr. Bronson totaled \$45,000, while those of his spouse totaled \$12,000.

At his death, Mr. Bronson had a net capital loss carry forward of \$30,000  $[(1/2)(\$60,000)]$ .

**Required:** Ignore GST and PST considerations.

- A. Assume Mr. Bronson's accountant does not split his pension income with his spouse. Calculate Mr. Bronson's minimum 2016 Net Income For Tax Purposes, his 2016 minimum Taxable Income, and his minimum 2016 federal Tax Payable without consideration of any instalment payments he may have made.
- B. Assume Mr. Bronson's accountant splits his pension income with his spouse and allocates \$41,500 in pension income to her. Calculate the overall federal tax savings due to the pension splitting.

## TIF PROBLEM ELEVEN - 13

### Comprehensive Tax Payable For Individuals

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Mr. Jack Leonard has asked you to assist him in preparing his 2016 tax return. To this end, he provides you with the following information.

Mr. Leonard's employer is a large, publicly traded corporation. During 2016, Mr. Leonard received a gross annual salary of \$58,000, living accommodations having a fair market value of \$3,000 per month, and an award of \$2,100 in recognition of outstanding job performance. The accommodations that were provided were not located in a remote region or prescribed zone. Awards for performance are paid instead of investing in employee benefits, so there is no pension plan and Mr. Leonard's 2015 Pension Adjustment amount is nil. His employer withheld the maximum for CPP contributions and EI premiums.

On August 1, 2016, his employer granted him an option to purchase 100 of its shares at a price of \$7 per share. The market price of the shares at that time was \$7 per share. On December 1, 2016, the market price of the shares had increased to \$16 per share. On that date, Mr. Leonard exercises his option and purchases the 100 shares. He is still holding the shares on December 31, 2016.

Mr. Leonard provides the following list of receipts and disbursements for the 2016 taxation year:

#### Receipts

Director's Fees	\$ 1,300
Royalties On Patent Purchased In 2008	24,070
Bond Interest	430

#### Disbursements

RRSP Contribution On July 6, 2016	\$16,000
Rent Paid To Employer For Living Accommodation	12,000
Financial Support Of His Aunt	7,100

You ascertain that his aunt is physically infirm, is wholly dependent upon Jack Leonard for support, had income of \$3,000 during the year, and lives in Florida for health reasons.

Mr. Leonard provides you with the following information on his dispositions of property during the year:

	Proceeds	Cost
Diamond Ring	\$1,200	\$ 950
Painting	1,100	1,800
Pistol Collection	2,000	1,400

On further enquiry, you learn that he is married and has one 19 year old son. Mr. Leonard's wife had income of \$2,990 during the year.

His son lives at home and was employed during twelve weeks of the summer at a golf course as a greens keeper, at a salary of \$250 per week. In September, he left his employment to commence full time studies at university. Tuition fees paid for the 2016 calendar year amounted to \$3,000, and were paid by Mr. Leonard. The son's only other source of income was \$700 in interest on bonds received from his father as a birthday gift in 2006. He will transfer any unused credits to his father.

Assume Mr. Leonard's 2015 Earned Income for RRSP purposes was equal to his 2016 Earned Income. At the beginning of 2016, Mr. Leonard has no unused deduction room or undeducted contributions.

**Required:** For 2016, compute the following amounts for Mr. Leonard:

- A. Net employment income.
- B. Income from property.
- C. Net taxable capital gains.
- D. Net Income For Tax Purposes.
- E. Taxable Income.
- F. Federal Tax Payable.

Show all required calculations, including those necessary to determine the maximum RRSP deduction for the year. In addition, indicate any available loss carry over amounts and the applicable loss carry over provisions.

## **TIF PROBLEM ELEVEN - 14**

### **Comprehensive Tax Payable For Individuals**

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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 2016 income tax return. Relevant financial information for 2016 is provided as follows:

- Mr. Tong received a gross salary of \$78,000 for the year. From this amount, Portus Ltd. deducted CPP contributions of \$2,544, EI premiums of \$955, and company pension contributions of \$3,900. In addition, in February, 2016, Portus Ltd. paid Mr. Tong a \$6,000 bonus based on his 2015 work performance. A 2016 bonus of \$9,500 was paid to him on March 1, 2017.

- In addition to his salary, Portus Ltd. paid the following employee benefits on Mr. Tong's behalf:

Company Pension Contributions	\$2,300
Group Term Life Insurance Premium (\$90,000 coverage)	650
Dental Insurance Premium	625

- 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 kilometers, of which 7,000 kilometers were for employment purposes.

- 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 meters of his 300 square metre home. During the year, he incurred the following expenses:

Home Expenses (100 Percent):		
Utilities	\$2,100	
Maintenance	750	
Insurance	820	
Property Tax	2,500	
Mortgage Interest	7,830	\$14,000
Office Supplies		230
Computer And Peripherals Purchase (100% Employment Use)		2,700
<b>Total Expenditures</b>		<b>\$16,930</b>

- 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.
- On December 21, 2016, Mr. Tong sold all of his 800 shares of Global Inc., a public corporation, for proceeds of \$8,600. The shares were acquired for \$11,000. On January 10, 2017, on the advice of his broker, he acquired 1,000 shares of Global Inc. for \$5,800.

7. Mr. Tong participates in Portus Ltd.'s stock option plan. In January, 2016, 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, 2016, when the shares are trading for \$15 per share using funding from a bank loan to pay the option price. During 2016, he paid \$1,200 interest on the bank loan.
8. In September, 2016, Mr. Tong receives an eligible dividend on his Portus shares of \$4,500. He uses the funds to purchase 250 more Portus shares at \$18 per share. In November, 2016, Mr. Tong sold 1,250 shares of Portus Ltd. at \$21 per share.
9. In 2015, Mr. Tong contributed \$4,300 to a spousal RRSP. His wife had not previously contributed to an RRSP. In August, 2016, Mr. Tong's wife withdrew \$1,000 from the RRSP to fund a jewelry purchase. Mrs. Tong had no income in 2016, other than \$360 in Universal Child Care Benefits. On February 10, 2017, Mr. Tong contributes \$8,000 to a spousal RRSP.
10. At the beginning of 2016, Mr. Tong had undeducted RRSP contributions carried forward from 2015 of \$2,200. Mr. Tong's 2015 Earned Income was \$61,500. Because he was only admitted to his employer's pension plan at the beginning of 2016, he has no 2015 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 her tuition fees of \$7,150. Any unused credits are available to be transferred to her father.
12. Mr. Tong purchased a sports car for \$2,500 on February 20, 2016, with the intent of restoring it for resale. He rebuilt the car and sold it to a collector for \$14,500 on April 10, 2016. He incurred costs of \$8,100 for new parts and supplies.
13. Mr. Tong incurred net capital losses of \$2,500 in 2010 [(1/2)(\$5,000)], \$6,000 in 2012 [(1/2)(\$12,000)], and \$3,000 in 2013 [(1/2)(\$6,000)]. He has not been able to deduct any of these amounts in previous years.

**Required:**

- A. Determine Mr. Tong's minimum Net Income For Tax Purposes and his minimum Taxable Income for the 2016 taxation year.
- B. Based on your answer to Part A, calculate Mr. Tong's minimum federal Tax Payable for the 2016 taxation year 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 2016.

In preparing the required information, ignore any GST or PST considerations.

## Chapter Twelve Test Item File Problems

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### TIF PROBLEM TWELVE - 1

#### Taxable Income And Tax Payable For Corporations - Essay Questions

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1. List three items that would be added to accounting net income in order to arrive at Net Income For Tax Purposes.
2. Indicate three deductions that are available to individuals in determining their Taxable Income, but not available to corporations.
3. One of your more socially conscious friends has just learned that dividends received by a Canadian corporation from other Canadian corporations are not subject to any form of taxation. In his view, this is additional evidence of how the government is allowing corporations to “rip-off” the Canadian public. Do you agree with the view being expressed by your friend? Explain your position.
4. What is the purpose of the stop loss rule applicable to shares that a corporation sells at a loss? When does this rule apply?
5. Compare the tax treatment of charitable donations for corporations with the treatment of charitable donations for individuals.
6. Briefly explain why dividends received are included in the definition of a Non-Capital Loss for a corporation.
7. A corporation has non-capital loss carry forwards and net capital loss carry forwards. How does management decide which of these carry forwards should be deducted first?
8. How does a corporation determine the amount of Taxable Income that will be allocated to the various provinces?
9. The federal tax abatement will sometimes be less than 10 percent of Taxable Income. Explain this statement.
10. The Canadian system of corporate taxation has goals other than raising revenue. Describe two of these other goals, including an example of a provision designed to achieve the goal described.
11. What are the general conditions that are required for the application of the small business deduction?
12. What is a specified investment business? This definition represents a solution to an administrative problem that caused difficulties for the CRA for many years. What was this problem?
13. Under what circumstances can interest income qualify as active business income for the purposes of the small business deduction?
14. With respect to both the small business deduction and the M&P deduction, the available amount is limited by the corporation’s Taxable Income for the year. Why is this limitation included in the calculation of these tax credits?

***Taxable Income And Tax Payable For Corporations - Essay Questions***

15. In the formula that limits the amount of the small business deduction, the Taxable Income limit is reduced by 4 times the corporation's foreign tax credit on business income. What is the reason for this reduction?
16. Why did policy makers conclude that, under certain circumstances, it was necessary to reduce the annual business limit that is available to an associated group of companies when calculating the small business deduction?
17. What is a "personal services business" as defined in the *Income Tax Act*? What special tax provisions apply to such businesses?
18. Explain why the M&P deduction is no longer important in the determination of federal Tax Payable. Given this, why has the legislation for this provision not been eliminated from the *Income Tax Act*?
19. Describe briefly the calculation of the general rate reduction for a CCPC that does not have any aggregate investment income.
20. In calculating the foreign business income tax credit, the "tax otherwise payable" does not include a deduction for the 10 percent federal tax abatement. Why is this the case?

**TIF PROBLEM TWELVE - 2****Taxable Income And Tax Payable For Corporations - True Or False**

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**New For 2016/2017**

1. While charitable donations cannot be deducted by a corporation, they can be used as the basis for a tax credit.

True or False?

2. When a corporation receives eligible dividends, they do not gross them up by 38 percent and include the grossed up amount in Net Income For Tax Purposes.

True or False?

3. For a corporation, dividends received from other taxable Canadian corporations are included in the determination of the non-capital loss for the current year.

True or False?

4. Because they expire after 20 years, non-capital losses should always be deducted prior to deducting net capital losses which have an unlimited carry forward period.

True or False?

5. Full Rate Taxable Income does not include income that is eligible for the small business deduction, but it does include income that is eligible for the manufacturing and processing deduction.

True or False?

6. In certain circumstances, rental income can be considered active business income.

True or False?

7. A Specified Investment Business is a business that primarily earns property income and employs in the business, throughout the year, more than 5 full-time employees

True or False?

8. If a corporation is classified as a Personal Services Business, the only deductions in the determination of its Net Income For Tax Purposes will be for salaries, wages, and other expenses that would normally be deductible against employment income.

True or False?

9. A Canadian controlled private company will never be able to use the General Rate Reduction provision.

True or False?

10. If amounts of taxes paid on foreign source business income are not used as a credit during the current year, they can be carried back to the 3 preceding taxation years and forward to the 10 subsequent taxation years.

True or False?

**Retained From Previous Editions**

11. Charitable contributions that are not used during the current year can be carried forward for five years, without regard to whether the taxpayer is an individual or a corporation.

True or False?

12. Non-capital loss carry overs must be deducted in the order in which they were incurred, the oldest one first, followed by amounts arising in later years.

True or False?

13. The base used for calculating the M&P deduction is reduced by the amount of the small business deduction.

True or False?

14. A corporation's non-business foreign income tax credit is limited to 15 percent of foreign non-business income earned.

True or False?

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

True or False?

**TIF PROBLEM TWELVE - 3****Taxable Income And Tax Payable For Corporations - Multiple Choice**

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**New For 2016/2017****Computation Of Net And Taxable Income**

1. During the 2016 taxation year, a corporation sells a depreciable asset with a capital cost of \$130,000 for \$140,000. The asset had a net book value in the accounting records of \$112,000. It was not the last asset in Class 8 and, prior to the disposition, the UCC balance for Class 8 was \$96,000. What is the amount of the adjustments that will be required in the conversion of the corporation's Net Income For Tax Purposes to Taxable Income?
  - A. A deduction of \$28,000, an addition of \$5,000, and an addition of \$34,000.
  - B. An addition of \$5,000 and an addition of \$34,000.
  - C. An addition of \$44,000.
  - D. A deduction of \$28,000 and an addition of \$5,000.
  
2. During the 2016 taxation year, Brocko Ltd. has a business loss of \$375,000, net taxable capital gains of \$67,000, an Allowable Business Investment Loss of \$23,000, and dividends from taxable Canadian corporations of \$53,000. What is the amount of the non-capital loss for the year?
  - A. \$384,000.
  - B. \$398,000.
  - C. \$322,000
  - D. \$331,000.

**Federal Tax Payable**

3. With respect to corporate Tax Payable, which of the following statements is **NOT** correct?
  - A. The effective federal tax rate on the active business income of a Canadian public company is 15 percent.
  - B. The federal tax abatement is always equal to 10 percent of corporate Tax Payable.
  - C. Canadian controlled private corporations may be eligible for the general rate reduction on some part of their income.
  - D. The manufacturing and processing deduction will not reduce the overall Tax Payable of a public company.

*Taxable Income And Tax Payable For Corporations - Multiple Choice***Small Business Deduction**

4. During the year ending December 31, 2016, Oxdor Ltd., a Canadian controlled private corporation had the following sources of income:

Active Business Income Earned In Canada	\$223,000
Active Business Income Earned In New York State	126,000
Net Taxable Capital Gains	43,000
Rent Received On An Unused Portion Of The Company's Manufacturing Facility	8,000
Investment Income Earned In Canada	16,000
<b>Net Income For Tax Purposes</b>	<b>\$416,000</b>
<hr/>	
<b>Taxable Income</b>	<b>\$245,000</b>

The Company paid no foreign taxes on its foreign operations. It is not associated with any other corporation.

What is the maximum amount of income on which the Company can claim the small business deduction?

- A. \$223,000  
 B. \$349,000  
 C. \$231,000  
 D. \$357,000
5. Which of the following statements with respect to the small business deduction is correct?
- A. If the company has no associated companies, its annual business limit will always be \$500,000.  
 B. A Specified Investment Company is a Canadian controlled private corporation whose primary purpose is earning property income and that has less than 5 full-time employees.  
 C. As long as the controlling shareholders of a corporation are residents of Canada for at least part of the year, the corporation will be considered a Canadian controlled private corporation.  
 D. Interest or rents earned by a Canadian controlled private company are not eligible for the small business deduction.

**Manufacturing And Processing Deduction**

6. Grande Ltd. is a Canadian controlled private company that is not associated with any other corporation. For 2016, it has active business income of \$723,000, of which \$617,000 involved manufacturing and processing activity. In addition, it has Canadian source investment income of \$65,000, resulting a Net Income For Tax Purposes \$788,000. This is also the Company's Taxable Income. What is the amount of Grande's manufacturing and processing deduction for the year?
- A. \$80,210  
 B. \$ 6,760  
 C. \$15,210  
 D. \$37,440

*Taxable Income And Tax Payable For Corporations - Multiple Choice***General Rate Reduction - ITA 123.4(2)**

7. For 2016, Fosfo Inc., a Canadian controlled private company, has Taxable Income of \$396,000. In calculating Tax Payable, the company received a small business deduction of \$35,875 and a manufacturing and processing deduction of \$6,500. What is the amount of Fosfo's 2016 general rate reduction?
- Nil
  - \$18,330.
  - \$45,971.
  - \$51,480.

**Foreign Tax Credits For Corporations**

8. With respect to the following statements about foreign source income and related tax credits for corporations, which one is **NOT** correct?
- If a credit related to foreign business income cannot be used during the current period, it can be carried back 3 years and carried forward 10 years.
  - Any amount of a corporation's foreign non-business tax credit in excess of 15 percent of foreign non-business income must be deducted in determining Net Income For Tax Purposes.
  - The foreign non-business tax credit may be less than the amount of foreign taxes withheld.
  - The gross amount of foreign sources income, without the deduction of amounts withheld, must be included in Net Income For Tax Purposes.

**Retained From Previous Editions****Computation Of Net And Taxable Income**

9. When dividends are paid by one taxable Canadian corporation to another taxable Canadian corporation, the recipient corporation will include the dividends in:
- Both Taxable Income and Net Income For Tax Purposes, but with an offsetting credit against Tax Payable.
  - Both Taxable Income and Net Income For Tax Purposes, with no offsetting credit against Tax Payable.
  - Neither Taxable Income nor Net Income For Tax Purposes.
  - Net Income For Tax Purposes, but not Taxable Income.
  - Taxable Income, but not Net Income For Tax Purposes.
10. With respect to charitable donations made by a corporation, which of the following statements is correct?
- They create a credit against Tax Payable, based on the corporation's tax rate prior to the deduction of the federal abatement.
  - If they cannot be used during the current year, they can be carried back three years.
  - They are a deduction in the determination of corporate Taxable Income but not corporate Net Income.
  - The amount of contributions that can be deducted is only limited by the corporation's Net Income For Tax Purposes for the year.
11. Which of the following items cannot be deducted in the determination of Taxable Income for a corporation?
- Dividends from taxable Canadian corporations.
  - Charitable contributions.
  - The lifetime capital gains deduction.
  - Net capital losses.

*Taxable Income And Tax Payable For Corporations - Multiple Choice*

12. Ottawa Corporation has accounting income for the year ended October 31, 2016 of \$76,000. Included in this calculation are the following amounts:

Meals and entertainment expenses	\$38,000
Amortization and depreciation	69,000
Landscaping costs	32,000
Dividend from Canadian subsidiary	52,000
Charitable donations	2,500

You have correctly determined CCA to be \$61,000. What are the correct amounts for first, Net Income for Tax Purposes, and second, Taxable Income?

- A. Net Income for Tax Purposes - \$105,500; Taxable Income - \$51,000.  
 B. Net Income for Tax Purposes - \$103,000; Taxable Income - \$51,000.  
 C. Net Income for Tax Purposes - \$73,500; Taxable Income - \$19,000.  
 D. Net Income for Tax Purposes - \$21,500; Taxable Income - \$19,000.
13. On November 23, 2015, Victoria Ltd. acquired 20 percent of the 15,000 issued shares of Vancouver Ltd. at a cost of \$32.50 per share. On December 20, 2015, these shares paid a dividend of \$2.25 per share, and on August 15, 2016, Victoria sells the shares for \$29 per share. What is the amount of the capital loss on the Vancouver Ltd. shares for Victoria Ltd. for the taxation year ended August 31, 2016?
- A. Nil  
 B. \$ 3,750  
 C. \$ 10,500  
 D. \$ 17,250

14. CCC Inc. is a Canadian controlled private corporation. During the year, CCC Inc. made charitable donations of \$13,000. It has a charitable donation carry forward from the preceding year of \$2,000. CCC Inc.'s Net Income For Tax Purposes for the current year consisted of \$91,000 of active business income, \$10,000 of dividends from taxable Canadian corporations and a net rental loss of \$84,000.

The maximum charitable donation deduction for CCC Inc. in the current year is:

- A. \$13,000  
 B. \$12,750  
 C. \$15,000  
 D. \$4,250

***Geographical Allocation of Income***

15. The two variables used to allocate income between permanent establishments when a corporation has permanent establishments in more than one province are:
- A. Gross salaries and net income for tax purposes of the establishment.  
 B. Gross revenue and salaries and wages paid by the establishment.  
 C. Gross revenue and net income for tax purposes of the establishment.  
 D. Gross salaries and allocated revenue of the establishment.

*Taxable Income And Tax Payable For Corporations - Multiple Choice*

16. Calgary Corporation has permanent establishments in Alberta, British Columbia and Seattle in the United States. Gross revenues, Net Income and salaries and wages for each permanent establishment are:

	Gross Revenue	Net Income For Tax Purposes	Salaries And Wages
Alberta	\$ 5,000,000	\$500,000	\$3,500,000
British Columbia	4,000,000	98,000	3,000,000
Seattle	4,500,000	325,000	2,000,000
Total	\$13,500,000	\$923,000	\$8,500,000

For the purposes of calculating the federal tax abatement, the percentage of income allocated to a Canadian province would be:

- A. 64.79%
- B. 65.72%
- C. 70.63%
- D. 71.57%

**Federal Tax Payable**

17. With respect to the determination of Tax Payable for a corporation, which of the following statements is **NOT** correct?
- A. The federal tax abatement percentage is reduced when less than 100 percent of the corporation's income is allocated to a province.
  - B. The basic tax rate applicable to corporations is 38 percent.
  - C. Provincial corporate taxes are based on a flat rate applied to a taxable income figure.
  - D. Full rate taxable income includes any income that is not eligible for the small business deduction.
18. Which of the following statements is correct?
- A. Public and private corporations are eligible for the general rate reduction.
  - B. All private corporations are eligible for the small business deduction.
  - C. Canadian controlled public and private corporations are eligible for the small business deduction.
  - D. If a corporation claims the small business deduction, it cannot claim the general rate reduction.

**Provincial Tax Payable**

19. With respect to determining provincial tax payable for a corporation, which of the following statements is correct?
- A. The provincial systems use a graduated rate structure similar to that used federally for individuals, and, except for Alberta and Quebec, the calculation of taxable income is the same as that used federally for corporations.
  - B. The provincial systems use a rate structure similar to the federal system for corporations, however, except for Alberta and Quebec, the calculation of taxable income is different from that used federally.
  - C. The provincial systems use a rate structure similar to the federal system for corporations and, except for Alberta and Quebec, the calculation of taxable income is the same as that used federally.
  - D. The provincial systems use a graduated rate structure similar to that used federally for individuals, however, except for Alberta and Quebec, the calculation of taxable income is different from that used federally.

*Taxable Income And Tax Payable For Corporations - Multiple Choice***Small Business Deduction**

20. The 17.5 percent small business deduction is only available on:
- Income earned in Canada by a resident corporation.
  - The first \$500,000 in manufacturing and processing income earned by a Canadian controlled private corporation.
  - The active business income of a private corporation with no more than five full-time employees devoted to the production of property income.
  - All of the income earned in Canada by a Canadian controlled private corporation.
  - None of the above.

21. Which of the following is an example of a Canadian controlled private corporation?
- A Canadian corporation in which 55 percent of the common shares are owned by Canadian residents and the remaining 45 percent of the common shares are owned by non-residents. The shares are all privately held.
  - A wholly-owned Canadian subsidiary of a public company.
  - A Canadian corporation in which Mr. Adams and Mr. Peters each own 50 percent of the shares. Both Mr. Adams and Mr. Peters are Canadian residents.
  - Both B and C.
  - Both A and C.

22. Village Concrete Inc. (Village) is a Canadian controlled private corporation (CCPC) with a year end of December 31, 2016. The owner of Village also controls Bob's Roofing Inc. (Bob's), another CCPC with active business income for the year ended December 31, 2016 of \$116,500. The owner has agreed to allocate a sufficient amount of the small business deduction to Bob's to ensure that all of its active business income is taxed at the lower rate.

Other than the income related items listed below, you may assume that Village's income is from active business in Canada.

Other information about Village:

- Village had a taxable capital gain in the year of \$2,000.
- Charitable donations were \$2,500.
- Recaptured CCA from operating assets was \$1,000.
- Net Income For Tax Purposes for the year was \$185,000.

What is the appropriate small business deduction for Village?

- \$32,025.
  - \$31,938.
  - \$31,850.
  - \$67,113.
23. Which of the following is a specified investment business?
- A business which principally derives its income from rental property and has less than 5 full-time employees.
  - A business which principally derives its income from rental property and has more than 5 full-time employees.
  - A business which principally derives its income from rental property and has 5 or more full-time employees.
  - A business which actively derives its income from rental property and has more than 5 full-time employees.

*Taxable Income And Tax Payable For Corporations - Multiple Choice*

24. In which of the following situations is a corporation earning incidental property income?
- A. Regina Corporation has built up its cash reserves over several years, and its staff invests this surplus cash in a variety of publicly traded corporations, earning dividend income. This income is approximately 10 percent of corporate income on an annual basis.
  - B. A branch of Moose Jaw Corporation invests surplus cash for 2-3 months every year earning interest income which is less than 1 percent of corporate income.
  - C. Saskatoon Corporation has one rental property which is leased to a retail outlet. The net rental income from this property is 5 percent of corporate income.
  - D. Lethbridge Limited sells its factory building resulting in a capital gain which is about 10 percent of corporate income.
25. A CCPC has Taxable Capital Employed in Canada for the 2015 year of \$14 million, and \$13.5 million for the 2016 year. The company has Canadian active business income of \$535,000, Taxable Income of \$435,000, and no foreign income. It is not associated with any other CCPC. What is the 2016 annual business limit reduction for this company?
- A. \$304,500.
  - B. \$350,000.
  - C. \$348,000.
  - D. \$400,000.
26. A CCPC has Taxable Capital Employed in Canada for the 2015 year of \$14 million, and \$13 million for the 2016 year. The company has Canadian active business income of \$420,000, Taxable Income of \$385,000, and no foreign income. It is not associated with any other CCPC. What is the 2016 small business deduction for this company?
- A. \$13,475.
  - B. \$28,700.
  - C. \$17,500.
  - D. \$35,000.
27. Ammar Dayani is a senior executive in a large oil producing company in Canada. He has heard that it would be beneficial from a tax perspective if he resigned his position, established a company in which he would be the only shareholder and employee, and then have the new company sign a contract with his former employer to provide the same services he currently provides as an employee. If Ammar proceeds with this idea, what deductions would the company be able to take that he cannot take as an employee?
- A. The company would be able to deduct all of the costs of operating the company, and would have the ability to pay a salary to Ammar and other family members to split income and reduce taxes.
  - B. The company would be able to deduct only the salary paid to Ammar.
  - C. The company would be able to deduct the salary paid to Ammar, any benefits paid on his behalf, and any other expenses that would normally be deductible against employment income.
  - D. The company would not be able to deduct any expenses as this would be a personal services corporation.

*Taxable Income And Tax Payable For Corporations - Multiple Choice*

28. DDD Ltd. is a private corporation. It is solely owned by Donald Dorsey who is a Canadian resident throughout the current year. During the year, DDD Ltd. had the following:

Canadian Active Business Income	\$145,500
Net Income For Tax Purposes	183,700
Taxable Income	157,800

What is the maximum small business deduction for DDD Ltd. for the current year?

- A. Nil  
 B. \$25,463  
 C. \$32,148  
 D. \$27,615
29. DDD Ltd. is a private corporation. It is solely owned by Donald Dorsey who was a Canadian resident until November 1 of the current year. On November 1 he left Canada permanently and became a resident of the U.S. During the year, DDD Ltd. had the following:

Canadian Active Business Income	\$145,500
Net Income For Tax Purposes	183,700
Taxable Income	157,800

What is the maximum small business deduction for DDD Ltd. for the current year?

- A. Nil  
 B. \$25,463  
 C. \$32,148  
 D. \$27,615
30. Samson and Delilah are high fashion hair stylists who worked for Philistines Inc., a large chain of hair salons, for 6 years. They incorporated Haaiir Inc. 2 years ago and each own 50 percent of the shares. They are the only employees of Haaiir Inc. and the corporation's only revenues are from work done for Philistines Inc. What type of income is Haaiir Inc. earning?
- A. Specified investment business income  
 B. Manufacturing and processing income  
 C. Personal services business income  
 D. Active business income

***Manufacturing And Processing Deduction***

31. With respect to the manufacturing and processing deduction, which of the following statements is **NOT** correct?
- A. The manufacturing and processing deduction is available to any corporation that has manufacturing and processing profits.  
 B. At the federal level, there is no tax advantage associated with the use of the manufacturing and processing deduction.  
 C. The amount of manufacturing and processing profits is determined by a formula that is found in the Income Tax Regulations.  
 D. The base for the manufacturing and processing deduction cannot exceed manufacturing and processing profits, reduced by the amount eligible for the small business deduction.

*Taxable Income And Tax Payable For Corporations - Multiple Choice***General Rate Reduction - ITA 123.4(2)**

32. Which of the following statements with respect to the general rate reduction for corporations is **NOT** correct?
- The general rate reduction is 13 percent of full rate taxable income.
  - Full rate taxable income for a public company is reduced by the income eligible for the manufacturing and processing deduction.
  - The general rate reduction is not available to Canadian Controlled Private Corporations (CCPCs).
  - Full rate taxable income for a CCPC is reduced by the income eligible for the manufacturing and processing deduction.
33. St. John Corporation, a Canadian controlled private corporation has Taxable Income of \$250,000 in 2016, 87 percent of which is earned in a Canadian province. The company reported Canadian active business income of \$235,000 for the year, and no foreign taxes were paid. The corporation has no M&P activity. It is associated with one other company, which received \$200,000 of the annual business limit. What is the federal Tax Payable for St. John Corporation for the 2016 year?
- \$ Nil.
  - \$26,925.
  - \$30,175.
  - \$33,237.

**Foreign Tax Credits For Corporations**

34. With respect to foreign business tax credits for corporations, which of the following statements is **NOT** correct?
- If the credit cannot be used during the current period, it can be carried back three years and forward ten years.
  - In the formula that limits this credit, the Tax Otherwise Payable is reduced by the federal tax abatement.
  - In the formula that limits this credit, the Tax Otherwise Payable is reduced by the general rate reduction.
  - In the formula that limits this credit, the Adjusted Division B Income is reduced by dividends that are deducted in the determination of Taxable Income.
35. Gander Limited is a Canadian controlled private corporation. In the current taxation year, the company has Taxable Income calculated as follows:

Net Income for Tax Purposes	\$246,000
Dividends Received	( 30,000)
Non-capital losses carried forward	( 45,000)
Net capital losses carried forward	( 5,000)
Taxable Income	\$166,000

The company earned foreign non-business income of \$25,000, from which tax of \$2,500 was withheld by the foreign government. What is the Adjusted Division B Income for Gander Limited for the current taxation year?

- \$166,000
- \$ 171,000
- \$ 191,000
- \$ 211,000

*Taxable Income And Tax Payable For Corporations - Multiple Choice*

36. Fredericton Corp. earned \$60,000 in foreign business income in the current fiscal year. Tax was paid to the foreign government in the amount of \$7,500 on this income. Fredericton Corp. has correctly calculated its federal Tax Payable before the foreign business income tax credit as \$15,250, calculated as follows:

Base Amount of Part I tax	\$48,000
Federal Tax Abatement	( 12,000)
Small Business Deduction	( 19,250)
General Rate Reduction	( 1,500)
<hr/>	
Federal Tax Payable Before Foreign Business Tax Credit	\$15,250
<hr/>	

What is the amount of Tax Otherwise Payable for purposes of the foreign business income tax credit calculation?

- A. \$27,250.
- B. \$34,500.
- C. \$46,500.
- D. \$48,000.

**TIF PROBLEM TWELVE - 4****Taxable Income And Tax Payable For Corporations -  
Exam Exercises**

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**Exam Exercise Subject Listing For Chapter 12**

Number	Subject
1	Schedule 1 Reconciliation
2	Schedule 1 Reconciliation
3	Corporate Taxable Income
4	Corporate Taxable Income
5	Stop Loss Rules
6	Stop Loss Rules
7	Non-Capital Loss Carry Forward
8	Non-Capital Loss Carry Forward
9	Net Capital & Non-Capital Loss Carry Forwards
10	Net Capital & Non-Capital Loss Carry Forwards
11	Geographical Allocation
12	Geographical Allocation
13	Small Business Deduction
14	Small Business Deduction
15	Small Business Deduction Reduction
16	M&P And SBD
17	M&P And SBD
18	Simple Federal Tax Payable - Public Company
19	Simple Federal Tax Payable - Public Company
20	Simple Federal Tax Payable - CCPC
21	Simple Federal Tax Payable - CCPC
22	Foreign Tax Credits
23	Foreign Tax Credits

*Taxable Income And Tax Payable For Corporations - Exam Exercises***Exam Exercise Twelve - 1 (Schedule 1 Reconciliation)**

You have been asked to prepare a Schedule 1 reconciliation of accounting Net Income and Net Income For Tax Purposes for the year ending December 31. Available information includes the following:

1. A capital asset was sold near the end of the year for \$93,000. It had a cost of \$89,300 and a net book value of \$26,400. It was not the last asset in its CCA class and the UCC of this class was \$263,000 before the disposition. There were no other additions or dispositions during the year.
2. During the year, the company has expensed estimated warranty costs of \$22,000.
3. During the year, the Company acquired goodwill at a cost of \$68,000. Since there was no impairment of the goodwill during the year, no write-down was required for accounting purposes.
4. Discount amortization on the company's bonds payable was \$2,300 for the current year.

**Required:** Determine the addition and/or deduction that would be made in Schedule 1 for each of the preceding items.

**Exam Exercise Twelve - 2 (Schedule 1 Reconciliation)**

The following items may involve an adjustment of a corporation's accounting Net Income in order to arrive at the Net Income For Tax Purposes figure.

1. Premium amortization on the company's bonds payable was \$5,600 for the current year.
2. The company incurred landscaping costs of \$16,000 during the current year. For accounting purposes, these costs are being amortized at the rate of \$1,600 per year.
3. The company sold a depreciable asset during the year for \$145,000. The asset had a capital cost of \$120,000 and a net book value of \$85,000. It was not the last asset in its CCA class and the UCC of this class was \$105,000 before the disposition. There were no other additions or dispositions during the year.
4. For accounting purposes, the company deducted \$4,500 of interest charged on late tax instalments.

**Required:** Determine the addition and/or deduction that would be made in Schedule 1 for each of the preceding items.

**Exam Exercise Twelve - 3 (Corporate Taxable Income)**

The FG Company had Net Income For Tax Purposes for the year ending December 31, 2016 of \$275,000. This amount included \$13,720 in taxable capital gains, as well as \$15,600 in dividends received from taxable Canadian corporations. Also during 2016, the Company made donations to registered charities of \$9,100.

At the beginning of the year, the Company had available a non-capital loss carry forward of \$74,000, as well as a net capital loss carry forward of \$20,000 [(1/2)(\$40,000)].

Determine the Company's minimum Taxable Income for the year ending December 31, 2016 and the amount and type of any carry forwards available at the end of the year.

*Taxable Income And Tax Payable For Corporations - Exam Exercises***Exam Exercise Twelve - 4 (Corporate Taxable Income)**

For the year ending December 31, 2016, Garba Inc. had Net Income For Tax Purposes of \$472,000. This amount included \$22,000 in dividends received from taxable Canadian companies, as well as \$12,400 in net taxable capital gains. The Company also made charitable donations during 2016 of \$14,500.

At the beginning of 2016, the Company had a non-capital loss carry forward of \$102,000, as well as a net capital loss carry forward of \$56,000.

Determine the Company's minimum Taxable Income for the year ending December 31, 2016 and the amount and type of any carry forwards available at the end of the year.

**Exam Exercise Twelve - 5 (Stop Loss Rules)**

On February 21, 2016, Markham Inc. acquires 1,000 shares of Darcy Ltd., a widely held public company, at a cost of \$27.60 per share. On March 1, 2016, these shares pay a dividend of \$1.97 per share. Markham sells the shares on March 25, 2016 for \$22.11 per share. Markham Inc. has taxable capital gains of \$23,000 in the year.

What is the amount of the allowable capital loss, if any, that Markham Inc. will include in its tax return for the taxation year ending December 31, 2016?

**Exam Exercise Twelve - 6 (Stop Loss Rules)**

During March, 2016, Invest Inc. acquires 5,000 shares of Glee Ltd., a widely held public company for \$18.95 per share. In May, 2016, the directors of Glee declare and pay a dividend of \$1.50 per share. In September, 2016, Invest sells the 5,000 Glee shares for \$16.75 per share. Invest Inc. has over \$50,000 in 2016 taxable capital gains on other share transactions.

What is the amount of the allowable capital loss, if any, that Invest Inc. will include in its tax return for the taxation year ending December 31, 2016?

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

Badon Inc. is a Canadian public company. The following information is for its taxation year ending December 31, 2016:

Capital Gains On Capital Asset Sales	\$204,000
Capital Losses On Public Company Stock Sales	171,000
Allowable Business Investment Loss	10,450
Dividends Received	87,000
Canadian Source Interest Income	53,100
Net Business Loss	427,500

The Company also has available a net capital loss carry forward of \$37,400 [(1/2)(\$74,800)]. It would like to deduct this loss during the current year.

Determine the non-capital loss balance [ITA 111(8)(b)] for Badon Inc. at the end of the 2016 taxation year and any available net capital loss carry forward.

## Taxable Income And Tax Payable For Corporations - Exam Exercises

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

For the taxation year ending December 31, 2016, Rude Ltd., a Canadian public company, recorded the following information:

Net Business Loss	\$286,000
Canadian Source Interest Income	42,000
Net Taxable Capital Gains	18,000
Dividends From Taxable Canadian Corporations	34,000
Allowable Business Investment Loss	23,000

At the beginning of 2016, the Company has a net capital loss carry forward available of \$24,000 [(1/2)(\$48,000)].

Determine the maximum non-capital loss balance [ITA 111(8)(b)] for Rude Ltd. at the end of the 2016 taxation year and any available net capital loss carry forward.

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

During the year ending December 31, 2015, Melanor Ltd. reported accounting Income Before Taxes of \$225,000. This was followed in the year ending December 31, 2016, by an accounting Loss Before Taxes of \$372,000. Both of these amounts were determined using generally accepted accounting principles. Included in the above income figures were the following amounts:

	2015	2016
Donations To Registered Charities	\$ 7,100	\$ 9,600
Gains (Losses) On The Sale Of Shares	33,000	( 17,000)
Dividends Received	23,000	37,000

The above accounting gains (losses) on the sale of shares are equal to the capital gains (losses) on the sale of the shares.

At the beginning of the 2015 taxation year, the Company has available a non-capital loss carry forward of \$12,000 and a net capital loss carry forward of \$10,000 [(1/2)(\$20,000)]. There has not been sufficient Net Income For Tax Purposes to deduct these amounts in any previous year. It is the policy of Melanor Ltd. to minimize non-capital loss carry overs.

**Required:** Calculate the minimum Net Income For Tax Purposes and Taxable Income for each of the two years 2015 and 2016 and indicate the amount and type of any carry overs that are available at the end of each year.

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

During the year ending December 31, 2015, Durham Inc. had GAAP based accounting income before taxes of \$427,000. The corresponding figure for 2016 was an accounting loss of \$625,000. Included in these figures were the following amounts:

	2015	2016
Dividends Received	\$41,000	\$58,000
Donations To Registered Charities	12,100	17,600
Gains (Losses) On The Sale Of Shares	65,000	( 31,000)

The above accounting gains (losses) on the sale of shares are equal to the capital gains (losses) on the sale of the shares.

At the beginning of 2015, Durham had available a non-capital loss carry forward of \$26,000 and a net capital loss carry forward of \$19,000 [(1/2)(\$38,000)]. It is the policy of Durham to minimize non-capital loss carry overs.

**Required:** Calculate the minimum Net Income For Tax Purposes and Taxable Income for each of the two years 2015 and 2016 and indicate the amount and type of any carry overs that are available at the end of each year.

*Taxable Income And Tax Payable For Corporations - Exam Exercises***Exam Exercise Twelve - 11 (Geographical Allocation)**

Ramsden Inc., a Canadian public company, has Taxable Income for the taxation year ending December 31, 2016 in the amount of \$242,000. It has Canadian permanent establishments in Saskatchewan and Alberta. The Company's gross revenues for the 2016 taxation year are \$3,013,000, with \$1,520,000 of this accruing at the permanent establishment in Saskatchewan, and \$912,000 accruing at the permanent establishment in Alberta. Wages and salaries total \$192,000 for the year. Of this total, \$63,000 is at the permanent establishment in Saskatchewan and \$85,000 is at the permanent establishment in Alberta. Ramsden has sales to the U.S. through a U.S. permanent establishment.

Calculate federal Tax Payable for the taxation year ending December 31, 2016. Ignore any foreign tax implications.

**Exam Exercise Twelve - 12 (Geographical Allocation)**

Marsden Inc., a Canadian public company, has 2016 Taxable Income of \$362,000. It has permanent establishments in Ontario, Manitoba and the U.S. Its 2016 gross revenues and 2016 wages and salaries at these establishments are as follows:

	<b>Gross Revenues</b>	<b>Wages And Salaries</b>
Ontario	\$ 840,000	\$ 300,000
Manitoba	1,080,000	540,000
U.S.	480,000	360,000
<b>Total</b>	<b>\$2,400,000</b>	<b>\$1,200,000</b>

Calculate federal Tax Payable for the taxation year ending December 31, 2016. Ignore any foreign tax implications.

**Exam Exercise Twelve - 13 (Small Business Deduction)**

Meridian Inc. is a CCPC throughout the year and is not associated with any other corporation. For the year ending December 31, 2016, Meridian has Net Income For Tax Purposes of \$522,000. This amount is made up of dividends from taxable Canadian corporations of \$72,000, active business income of \$400,000, and foreign non-business income of \$50,000. The foreign income was subject to withholding in the foreign jurisdiction at a rate of 13 percent. Meridian receives a foreign tax credit against federal Tax Payable that is equal to the amount withheld. Meridian has a non-capital loss carry forward of \$145,000 which it intends to deduct during 2016.

Determine the amount eligible for the small business deduction for the year ending December 31, 2016.

**Exam Exercise Twelve - 14 (Small Business Deduction)**

Sardo Ltd. is a CCPC through the 2016 taxation year. It has a December 31 year end and is not associated with any other companies. Its \$472,000 Net Income For Tax Purposes is made up of the following components:

Active Business Income	\$375,000
Dividends From Taxable Canadian Corporations	65,000
Foreign Non-Business Income (100%)	32,000

The foreign jurisdiction withheld \$3,200 from the foreign non-business income. The Company receives a credit against federal Tax Payable for this amount.

The Company has a non-capital loss carry over of \$96,000 that it intends to deduct during 2016.

Determine the amount eligible for the small business deduction for the year ending December 31, 2016.

*Taxable Income And Tax Payable For Corporations - Exam Exercises***Exam Exercise Twelve - 15 (Small Business Deduction Reduction)**

Teeny Ltd. is a Canadian controlled private corporation. Its Net Income For Tax Purposes is \$652,000 for the year ending December 31, 2016, all of which is active business income, except for \$21,000 in foreign source non-business income. Ten percent of this amount was withheld in the foreign jurisdiction, and the corporation receives a foreign tax credit against federal Tax Payable that is equal to the amount withheld. The corporation's only deduction in the calculation of Taxable Income is for a non-capital loss carry forward of \$415,000. The corporation had Taxable Capital Employed In Canada of \$12,950,000 for the year ending December 31, 2015, and \$13,100,000 for the year ending December 31, 2016. It is not associated with any other corporation.

Determine the amount of Teeny Ltd.'s small business deduction for the year ending December 31, 2016.

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

Bartlett Operations Inc. is a Canadian controlled private corporation throughout 2016. It has Net Income For Tax Purposes of \$476,000, a figure that includes \$424,000 in manufacturing and processing profits (as per ITR 5200). The \$476,000 also includes foreign source business income of \$25,000 and taxable capital gains of \$27,000. Because of withholding on the foreign source business income, the Company is entitled to a foreign tax credit of \$3,700. The Company's only deduction in the calculation of Taxable Income is donations to registered Canadian charities in the amount of \$201,000. Bartlett is not associated with any other company and anticipates large increases in Taxable Income in the next few years.

Determine the amount of Bartlett's small business deduction and M&P deduction for the year ending December 31, 2016, assuming that the Company deducts all of the \$201,000 of charitable donations. Do you believe that deducting all of the donations is the best alternative for Bartlett? Explain your conclusion.

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

Lardon Inc. is a CCPC throughout the year ending December 31, 2016. Lardon is not associated with any other company. For 2016, the Company has Net Income For Tax Purposes of \$652,000, an amount that includes \$553,000 in manufacturing and processing profits (as per ITR 5200). The Company's Net Income For Tax Purposes also includes foreign source business income of \$40,000 and taxable capital gains of \$59,000. The jurisdiction in which the foreign business income was earned withheld an amount that will result in Lardon being entitled to a foreign tax credit of \$6,000. The Company's only deduction in calculating Taxable Income is a donation to a registered charity of \$187,000.

Due to rumours of illegal activities, just prior to year end, Lardon lost two major customers and many of its key staff.

Determine the amount of Lardon's small business deduction and M&P deduction for the year ending December 31, 2016, assuming that the Company deducts all of the \$187,000 of charitable donations. Do you believe that deducting all of the donations is the best alternative for Lardon? Explain your conclusion.

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

For the year ending December 31, 2016, Tuleta Ltd., a Canadian public company, has Taxable Income of \$296,000. Of this total, \$165,000 qualifies for the M&P deduction. Calculate Tuleta Ltd.'s federal Tax Payable for the year ending December 31, 2016. Include in your solution any M&P deduction available.

*Taxable Income And Tax Payable For Corporations - Exam Exercises***Exam Exercise Twelve - 19 (Simple Federal Tax Payable - Public Company)**

During its current taxation year, Odaon Ltd., a Canadian public company, has Taxable Income of \$625,000. Of this total \$362,000 qualifies for the M&P deduction. Calculate Odaon's federal Tax Payable for the current taxation year. Include in your solution any M&P deduction available.

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

Danforth Inc. is a Canadian controlled private corporation. For the year ending December 31, 2016, the Company has Taxable Income of \$262,000, all of which is active business income. Of this amount, \$201,000 results from M&P activity. As it is associated with two other corporations, its share of the annual business limit is \$117,000. Determine the Company's federal Tax Payable for the year ending December 31, 2016. Include in your solution any M&P deduction available.

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

For the year ending December 31, 2016, Brokton Inc. has Taxable Income of \$472,000, all of which is active business income. Of this total, \$305,000 results from M&P activity. The Company is a CCPC and is associated with three other CCPCs. The companies have agreed that Brokton's shares of the annual business limit will be \$140,000. Determine the Company's federal Tax Payable for the year ending December 31, 2016. Include in your solution any M&P deduction available.

**Exam Exercise Twelve - 22 (Foreign Tax Credits)**

Tembina Ltd. is a Canadian public company. For the year ending December 31, 2016, it has Net Income For Tax Purposes of \$135,000, including foreign business income of \$27,000. The foreign government withheld \$4,050 in taxes on this income, resulting in a net remittance of \$22,950. None of the Company's income involves manufacturing and processing and, based on the ITR 402(3) formula, 91 percent of the Company's income was allocated to a province. In calculating Taxable Income, the Company deducts \$23,000 in dividends received from taxable Canadian corporations, a non-capital loss carry forward of \$51,000, and a net capital loss carry forward of \$19,000.

Determine the Company's Part I Tax Payable for the year ending December 31, 2016. Include in your answer any carry overs available at the end of the year.

**Exam Exercise Twelve - 23 (Foreign Tax Credits)**

For the year ending December 31, 2016, Sundal Ltd. has Net Income For Tax Purposes of \$265,000. Included in this amount is foreign business income of \$48,000. The foreign jurisdiction withheld \$7,200 in taxes, resulting in a net remittance of \$40,800. Sundal is a Canadian public company and none of its income involves M&P activity. It has been determined that 89 percent of the Company's income can be allocated to a province.

In determining the Company's Taxable Income, deductions were made for dividends of \$41,000, a non-capital loss carry forward of \$105,000, and a net capital loss carry forward of \$36,000, resulting in a Taxable Income of \$83,000.

Determine the Company's Part I Tax Payable for the year ending December 31, 2016. Include in your answer any carry overs available at the end of the year.

**TIF PROBLEM TWELVE - 5A****Tax Payable For Corporations - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 12, "Taxable Income and Tax Payable For Corporations".

- A. Annual Business Limit
- B. Canadian Controlled Private Corporation
- C. Federal Tax Abatement
- D. Full Rate Taxable Income
- E. General Rate Reduction
- F. Permanent Establishment
- G. Private Corporation
- H. Small Business Deduction

The following list contains ten potential definitions for the preceding key terms.

1. A corporation that is controlled by persons resident in Canada and that does not have any of its shares listed on a designated stock exchange.
2. A corporation that provides the services of a specified shareholder [ITA 248(1)] who could reasonably be regarded as an officer or employee of the business, and that does not have five or more other full time employees throughout the year.
3. A corporation that does not have five or more full time employees throughout the year, whose principal purpose is to derive income from property.
4. A corporation that is a resident of Canada, but is not a public corporation.
5. A 10 percentage point reduction in the federal tax rate on corporations, applicable to income earned in a province.
6. A percentage point deduction in the calculation of corporate tax payable that is designed to reduce the general corporate tax rate of 38 percent.
7. A deduction in the calculation of corporate tax payable equal to 17.5 percentage points on the first \$500,000 of active business income earned by a CCPC.
8. The maximum amount of active business income that is eligible for the small business deduction in a particular taxation year.
9. A fixed place of business of a corporation.
10. Two or more corporations that have an ownership/control arrangement that falls into one of the categories described in ITA 256(1).

*Tax Payable For Corporations - Key Term Matching (Easy)*

11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM TWELVE - 5B****Tax Payable For Corporations - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 12, "Taxable Income and Tax Payable For Corporations".

- A. Annual Business Limit
- B. Canadian Controlled Private Corporation
- C. Federal Tax Abatement
- D. Full Rate Taxable Income
- E. General Rate Reduction
- F. Permanent Establishment
- G. Private Corporation
- H. Small Business Deduction

The following list contains 14 potential definitions for the preceding key terms.

1. A corporation that is controlled by persons resident in Canada and that does not have any of its shares listed on a designated stock exchange.
2. A corporation that provides the services of a specified shareholder [ITA 248(1)] who could reasonably be regarded as an officer or employee of the business, and that does not have five or more other full time employees throughout the year.
3. The maximum amount of income that is eligible for the small business deduction in a particular taxation year.
4. A corporation that does not have five or more full time employees throughout the year, whose principal purpose is to derive income from property.
5. A corporation that is a resident of Canada, but is not a public corporation.
6. A 10 percentage point reduction in the federal tax rate on corporations, applicable to income earned in a province.
7. A percentage point deduction in the calculation of corporate tax payable that is designed to reduce the general corporate tax rate of 38 percent.
8. A corporation that is controlled by individuals who are citizens of Canada and that does not have any of its shares listed on a designated stock exchange.
9. A deduction in the calculation of corporate tax payable equal to 17.5 percentage points on the first \$500,000 of active business income earned by a CCPC.
10. The maximum amount of active business income that is eligible for the small business deduction in a particular taxation year.

*Tax Payable For Corporations - Key Term Matching (Moderate)*

11. A corporation that has five or more full time employees throughout the year, whose principal purpose is to derive income from property.
12. A fixed place of business of a corporation.
13. Two or more corporations that have an ownership/control arrangement that falls into one of the categories described in ITA 256(1).
14. A percentage point deduction in the calculation of corporate Tax Payable that is designed to reduce the general corporate tax rate to 38 percent.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM TWELVE - 6**

### **Corporate Net Income**

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One of your junior assistants, Mr. John Ying, has been calculating Net Income For Tax Purposes for Yang Inc. for the current year ending December 31. While he has completed the Schedule 1 reconciliation, there are a number of items on which he is asking for your verification of his conclusion. The items are as follows:

1. During the year ending December 31, the Company made charitable donations of \$15,000. This amount was deducted in the accounting records and your assistant is certain that this amount will be considerably less than 75 percent of the current year's Net Income For Tax Purposes.
2. During December of the current year, the Company sold its only Class 43 asset for \$120,000. The original cost of the asset was \$215,000 and its net book value at the time of sale was \$162,000. At the beginning of the year, the Class 43 UCC was \$131,500. No additional Class 43 assets were acquired during the current year.
3. At the beginning of the current year, Yang Inc. acquired all of the assets of another business and, in the process, paid \$97,000 for the goodwill of the business. For accounting purposes, a \$19,400 write-down for a goodwill impairment loss was taken for the current year. The goodwill qualifies as an eligible capital expenditure for tax purposes.
4. During the current year, the Company has recorded amortization expense of \$176,000. The maximum CCA that the Company could deduct for the current year is \$220,000. They have instructed you to deduct the maximum CCA.
5. During December of the current year, the Company sold a parcel of unneeded land for \$250,000, receiving one-quarter of this amount in cash and the other three-quarters in the form of a note to be paid after five years. The cost and adjusted cost base of the land was \$175,000.
6. The Company has a variety of bond issues outstanding, some of which were issued at a discount and others at a premium. The interest expense deducted in the accounting records on these bonds was \$122,500. This amount reflected \$3,000 in premium amortization and \$4,200 in discount amortization.
7. The Company paid \$25,000 for five memberships in a local golf club for its employees. These employees were all commission sales persons and, during the current year, they spent \$47,000 entertaining clients at the club. The Company did not reimburse the sales persons for these expenses.

**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.

## **TIF PROBLEM TWELVE - 7**

### **Corporate Taxable Income**

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The following information on Dunway Ltd., a Canadian public company, is applicable to the year ending June 30, 2016:

Sales Of Merchandise	725,000
Operating Expenses	533,000
Dividends From Controlled Subsidiary	37,500
Dividends From Non-Controlled Public Companies	15,000
Capital Gain On Investment Sale	222,000
Dividends Paid	182,000
Donation To Canadian Government	26,000
Donations To Registered Canadian Charities	141,000

At the beginning of this fiscal year, the Company has available a net capital loss carry forward of \$180,000 [(1/2)(\$360,000)] and a non-capital loss carry forward of \$137,000. Dunway Ltd. does not anticipate having any capital gains in the foreseeable future.

**Required:** Calculate the minimum Net Income For Tax Purposes and Taxable Income for Dunway Ltd. for the year ending June 30, 2016. Indicate the amount and type of any carry forwards that will be available for use in future years.

## **TIF PROBLEM TWELVE - 8**

### **Corporate Net And Taxable Income**

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When it was incorporated, Sedux Inc. chose to have a December 31 year end. However, the nature of their business is such that winter is a peak period and having a September 30 year end would coincide with their slack period. For 2016, it has received permission from the CRA to change its year end to September 30.

Its Income Statement for the period January 1, 2016 through September 30, 2016, prepared in accordance with GAAP, is as follows:

<b>Sedux Inc.</b>	
<b>Income Statement</b>	
<b>9 Month Period Ending September 30, 2016</b>	
Sales (All Within Canada)	\$763,000
Cost Of Sales	( 402,000)
<hr/>	
Gross Margin	\$361,000
Other Expenses (Excluding Taxes):	
Wages And Salaries	(\$126,000)
Amortization	( 46,000)
Rent	( 72,000)
Interest Expense	( 4,600)
Foreign Exchange Loss	( 3,400)
Travel And Promotion	( 28,000)
Bad Debt Expense	( 4,900)
Warranty Reserve	( 4,700)
Charitable Donations	( 2,400)
Other Operating Expenses	( 17,000)
<hr/>	
Operating Income	\$ 52,000
Gain On Sale Of Investments	3,000
<hr/>	
Income Before Taxes	<u>\$ 55,000</u>

#### **Other Information:**

1. During the period January 1, 2016 through September 30, 2016, the Company declared and paid dividends of \$23,000.
2. On January 1, 2016, the Company has available a \$16,000 non-capital loss carry forward and a \$5,000 [(1/2)(\$10,000)] net capital loss carry forward.
3. In determining the Cost Of Sales, the Company included a \$15,000 reserve for inventory obsolescence.
4. Wages and salaries includes a \$10,000 bonus to Sedux Inc.'s CEO. Because he anticipates retiring at the end of 2017, this bonus will not be paid until January, 2018.
5. Amortization is on the furniture and fixtures and delivery vehicles. The capital cost of the furniture and fixtures is \$125,000 and, at January 1, 2016, the Class 8 UCC balance is \$68,000. During 2016, new furniture was acquired at a cost of \$18,000. Old furniture with a capital cost of \$12,000 was sold for \$8,000.  
  
On January 1, 2016, the Class 10 UCC balance was \$85,000. There were no additions or disposals in this Class during the 9 month period ending September 30, 2016.
6. The interest expense relates to a line of credit that was used to finance seasonal fluctuations in inventory.
7. The foreign exchange loss resulted from the financing of merchandise purchases in Italy.

**TIF Problem Twelve - 8**  
*Corporate Net And Taxable Income*

8. The travel and promotion expense consisted of the following items:

Business Meals And Entertainment	\$10,000
Hotels And Airfare	14,000
Golf Club Memberships	4,000
<hr/>	
Total Travel And Promotion Expense	\$28,000
<hr/>	

9. This is the first year that the Company has deducted a warranty reserve.

**Required:** Calculate the minimum Net Income For Tax Purposes and Taxable Income for Sedux Inc., for the 9 month period ending September 30, 2016. Indicate the amount and type of any carry forwards that will be available for use in future years.

**TIF PROBLEM TWELVE - 9****Corporate Loss Carry Forwards - 1 Year**

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Verax Inc. has a December 31 year end. During the 2016 taxation year, the records of Verax Inc. contain the following results. As Verax keeps its records on the basis of tax rules, all of the amounts are based on the relevant tax rules.

Dividends From Taxable Canadian Corporations	\$36,450
Taxable Capital Gains	27,360
Allowable Capital Losses	4,990
Net Business Loss	152,480

The records also indicate that, during this taxation year, the Company made charitable donations of \$3,940.

At the beginning of the 2016 taxation year, Verax has a net capital loss carry forward of \$55,725 [(1/2)(\$111,450)], a non-capital loss carry forward of \$44,560, and unused charitable donations from 2015 of \$4,220.

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 corporation's minimum Net Income For Tax Purposes and Taxable Income for its 2016 taxation year. Indicate any balances available for carry forward to subsequent years.

## **TIF PROBLEM TWELVE - 10**

### **Corporate Loss Carry Forwards - 1 Year**

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At the beginning of 2016, Lyric Ltd. has a net capital loss balance of \$78,250, a non-capital loss carry forward of \$61,400, undeducted charitable contributions of \$6,400. It is the policy of the Company to minimize any net capital loss balance, prior to using non-capital loss carry overs.

During 2016, the Company's overall operations were unsuccessful, resulting in a business loss of \$225,000. Offsetting this were \$51,500 in dividends from taxable Canadian corporations and capital gains of \$41,500. However, the capital gains were offset by capital losses of \$7,300.

Despite the business loss, the Company continued its charitable giving program, making 2016 donations of \$6,300.

**Required:** Calculate the corporation's minimum Net Income For Tax Purposes and Taxable Income for its 2016 taxation year. Indicate any balances available for carry forward to subsequent years.

## **TIF PROBLEM TWELVE - 11**

### **Corporate Loss Carry Forwards - 4 Years**

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Brockton Ltd. has a December 31 fiscal year end. It began operations on January 1, 2013. During the 4 years 2013 through 2016, the components of its income were as follows:

	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
Net Business Income (Loss)	\$123,000	\$18,000	(\$85,000)	\$32,000
Capital Gains (Losses)	( 12,000)	32,000	( 25,000)	16,000
Dividends Received	6,000	7,000	6,000	9,000
Charitable Donations	1,500	8,500	4,200	1,800

The Company uses tax rules to determine its Net Business Income (Loss). All of the dividends have been received from taxable Canadian corporations.

It is the policy of the Company to minimize its net capital loss carry forward balance, prior to minimizing other types of carry forwards.

**Required:** For each of the four years 2013 through 2016, provide the following information:

- The minimum Net Income For Tax Purposes and Taxable Income that would be reported for Brockton Ltd. Indicate the amount and type of any current year losses that are available for carry back or carry forward.
- The amended figures for any years to which losses are carried back.
- An analysis of the amount and type of carry forwards that would be available at the end of the year.

## **TIF PROBLEM TWELVE - 12**

### **Geographical Allocation Of Income**

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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 provinces where the Company has operations in the following manner:

<b>Province</b>	<b>Wages And Salaries Accrued</b>	<b>Gross Revenues</b>
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 totaled \$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.

**TIF PROBLEM TWELVE - 13****Part I Tax With Reduced Small Business Deduction**

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Kalec Inc. has a December 31 year end for both tax and accounting purposes. It is a Canadian controlled private company (CCPC) and, for the taxation year ending December 31, 2016, it had a Taxable Capital Employed In Canada of \$11,556,000. The corresponding figure for the year ending December 31, 2015 was \$12,235,000.

Taxable Income for the 2016 taxation year was \$879,000. This was made up of Canadian active business income of \$762,000, along with foreign business income of \$117,000. The foreign jurisdiction withheld \$17,550 in taxes, remitting the balance of \$99,450 to Kalec.

The Company's 2016 gross revenues totalled \$2,550,000, with 22 percent of this total being generated outside of Canada. Of their total 2016 wages of \$895,000, 17 percent were paid outside of Canada. The revenues were earned and the wages paid in a country where Kalec has a permanent establishment.

Kalec Inc. is required to share its small business deduction with three other associated companies. They have agreed that Kalec would be allocated 40 percent of the total amount available.

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

**Required:** Calculate Kalec's minimum federal Part I Tax Payable for the year ending December 31, 2016.

## **TIF PROBLEM TWELVE - 14**

### **Corporate Tax Payable**

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Blackman Inc. is a Canadian controlled private corporation that has a December 31 taxation year end.

For the taxation year ending December 31, 2016, the Company's Net Income For Tax Purposes was \$624,300. This was made up of \$426,300 of Canadian active business income and \$198,000 of dividends from various Canadian public companies. Using the formula from the *Income Tax Regulations*, it has been determined that \$334,000 of the active business income qualifies as manufacturing and processing profits.

**Other Information:**

1. Blackman Inc. is associated with four other CCPCs. The companies have agreed that each company will claim 20 percent of the annual business limit.
2. At the beginning of the 2016 taxation year, Blackman has a \$72,400 non-capital loss carry forward. The Company intends to deduct the full amount of this carry forward during 2016.
3. During the 2016 taxation year, the Company make contributions to registered charities in the amount of \$64,700.

**Required:** Determine the minimum Taxable Income and Part I federal Tax Payable for Blackman Inc. for the year ending December 31, 2016. Show all calculations, whether or not they are necessary to the final solution. As the corporation operates in a province that has a reduced tax rate for M&P activity, a separate calculation of the federal M&P deduction is required.

## **TIF PROBLEM TWELVE - 15**

### **Corporate Tax Payable With FTC**

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Worldwide Enterprises was established 15 years ago and has been a Canadian controlled private corporation since its incorporation. Its head office is located in Vancouver and it has branches (permanent establishments) in both Seattle, Washington and Portland, Oregon. Its taxation year ends on December 31. All of the Company's Canadian income is active business income.

During the 2016 taxation year, the Company's Net Income For Tax Purposes and Taxable Income amount to \$219,000. This amount includes \$32,000 (Canadian) that was earned by the two branches operating in the United States. The \$32,000 earned by these branches is before the deduction of any U.S. or Canadian income taxes. As a result of earning this amount in the United States, the Company was required to pay \$6,200 (Canadian) in U.S. federal income tax and \$3,400 (Canadian) in state income taxes.

For purposes of calculating the federal tax abatement, assume that applying the ITR 402(3) formula results in 90 percent of the Company's Taxable Income being allocated to Canadian provinces.

**Required:**

- A. Calculate Worldwide Enterprises' federal Part I Tax Payable for the 2016 taxation year. Assume the foreign business income tax credit is equal to the foreign tax withheld.
- B. Using the amounts determined in Part A, calculate the actual foreign tax credits that will be deducted (they may be equal to the amount withheld).

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

## **TIF PROBLEM TWELVE - 16**

### **Corporate Tax Payable With M&P**

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Zenox Ltd. is a Canadian controlled private corporation (CCPC) with all of its operations located in Saskatchewan. Sharon Zenox owns 100 percent of the outstanding shares of this Company. At the beginning of 2016, the Company has a non-capital loss carry forward of \$54,000. The Company intends to deduct this carry forward during the year.

For the 2016 taxation year, Zenox has Net Income For Tax Purposes of \$625,000. This is made up of \$523,000 in income from business activity and \$102,000 in dividends from various Canadian public companies. Using the formula from the *Income Tax Regulations*, it has been determined that \$416,000 of the business income results from manufacturing and processing activity.

During 2016, the Company donated \$46,000 to a registered Canadian charity.

Zenox Ltd. is associated with another CCPC. The two companies have agreed that each company will claim one-half of the annual business limit.

**Required:** Determine the minimum Taxable Income and Part I federal Tax Payable for Zenox Ltd. for the year ending December 31, 2016. Show all calculations, whether or not they are necessary to the final solution. As the corporation operates in a province that has a reduced tax rate for M&P activity, a separate calculation of the federal M&P deduction is required.

## TIF PROBLEM TWELVE - 17

### Comprehensive Corporate Tax Payable

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For the year ending December 31, 2016, the Income Statement of Morland Industries Ltd. (MIL), a Canadian controlled private corporation, prepared in accordance with generally accepted accounting principles, is as follows:

Revenues		\$1,734,000
Expenses:		
Cost Of Goods Sold	(\$456,000)	
Selling And Administrative Costs	( 270,000)	
Amortization Expense	( 285,000)	
Other Expenses	( 246,000)	( 1,257,000)
<hr/>		
Operating Income		\$ 477,000
Other Income And Losses		
Foreign Business Income		
(Net Of \$2,400 Withholding)	\$ 9,400	
Dividends From Taxable Canadian Corporations	37,000	
Gain On Sale Of Building	75,000	
Gain On Sale Of Vacant Land	51,000	
Loss On Sale Of Vehicles	( 40,000)	132,400
<hr/>		
Accounting Income Before Taxes		\$609,400
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#### Other Information:

1. On January 1, 2016, MIL had the following UCC balances:

Class 1		\$819,354
Class 8		985,261
Class 10		96,417
Class 13		187,000

The Class 1 balance relates to a single building acquired at a cost of \$1,145,000. It is estimated that the land that is included in this amount is \$200,000. On February 1, 2016, this building is sold for \$1,185,000, including an estimated value for the land of \$225,000. In the accounting records, this real property was carried at \$1,110,000, a net book value of \$910,000 for the building and \$200,000 for the land.

The old building is replaced on February 15, 2016 with a new building acquired at a cost of \$1,425,000, of which \$260,000 is allocated to land. The building is used 95 percent for manufacturing and processing activity and it is allocated to a separate Class 1.

There are no dispositions of Class 8 assets during the year. However, there are acquisitions in the total amount of \$98,000.

As the Company has decided to lease all of its vehicles in the future, all of the assets in Class 10 are sold during the year. The capital cost of these assets was \$193,000 and the proceeds of disposition amounted to \$77,000. The net book value of these assets was \$117,000.

The Class 13 balance relates to a single lease that commenced on January 1, 2014. The lease has an initial term of 7 years, with two successive options to renew, each for 3 years. Expenditures on this leasehold were \$180,000 in 2014 and \$36,000 in 2015. There were no further expenditures in 2016. The write-off of these expenditures for accounting purposes is included in Amortization Expense.

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

2. Some years ago, MIL acquired a tract of land for \$572,000. Until recently, they had intended to construct a new building for their operations on this site. However, with the 2016 purchase of a new building, their plans changed and they sold the tract for \$623,000. The buyer provided a \$50,000 cash payment, with MIL taking back a mortgage for the balance. The balance will be paid in 10 equal instalments in the years 2017 through 2026.
3. Selling And Administrative Costs include \$32,000 in business meals and entertainment. This balance also includes membership fees of \$14,600 that were paid for several employees in a local golf and country club. This club is used for entertaining business clients.
4. As the Company expects to issue more shares during 2017, it made a number of amendments to its articles of incorporation and included the legal costs in Other Expenses. These costs totaled \$13,500.
5. Other Expenses also includes the following:
 

Bond discount amortization	\$3,500
Donations to registered charities	3,400
Interest on late income tax instalments	900
Interest on late municipal tax payments	475
6. The Company spent \$15,000 during the year on landscaping for its new building. For accounting purposes this was treated as an asset. MIL will not amortize this balance as it believes the work has an unlimited life.
7. During 2015, MIL acquired a competing business at a price that included goodwill of \$85,000. For accounting purposes, there has been no impairment or write-down of the goodwill purchased since its acquisition. MIL had not acquired any eligible capital expenditures prior to 2015.
9. At the beginning of 2016, MIL had a net capital loss carry forward of \$128,000, as well as a non-capital loss carry forward of \$60,300.
10. For 2016, MIL has active business income in Canada of \$613,168, none of which results from M&P activity.
11. MIL is associated with several other CCPCs. MIL's share of the group's annual business limit for 2016 is \$150,000.
12. Using the formula found in the *Income Tax Regulations*, 93 percent of MIL's income has been allocated to provinces. Assume that the tax credit for the foreign taxes on the foreign business income is equal to the amount withheld.

**Required:**

- A. Calculate the minimum Net Income For Tax Purposes for Morland Industries Ltd. for 2016. In addition, calculate the UCC for each class of assets and the cumulative eligible capital balance on January 1, 2017.
- B. Calculate the minimum Taxable Income for Morland Industries Ltd. for 2016. Indicate the amount, and type, of any carry overs that are available at the end of the year.
- C. Calculate the minimum federal Part I Tax Payable for Morland Industries Ltd. for 2016. Assume that the foreign tax credit for foreign business income is equal to the foreign taxes withheld.

## Chapter Thirteen Test Item File Problems

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### TIF PROBLEM THIRTEEN - 1

#### Corporate Investment Income - Essay Questions

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1. The theories or perspectives of corporate taxation are referred to as the entity view and the integration view. Briefly describe these two views.
2. The concept of integration is central to the Canadian system of corporate taxation. Briefly explain the basic objective of integration as it is applied in the Canadian system of corporate taxation.
3. Explain, without using examples, how the dividend gross up and tax credit procedures assist in achieving the goal of the integration approach to taxing CCPCs and their shareholders. Assume any dividends paid are not designated eligible.
4. What are the components of "aggregate investment income" as described in ITA 129(4)?
5. What are the major differences between aggregate investment income as described in ITA 129(4), and property income as described in subdivision b of the *Income Tax Act*.
6. In the absence of the Part I refundable tax, the total personal and corporate taxes on investment income earned by, and flowed through, a CCPC could approach an unreasonably high 70 percent. While the Part I refundable tax reduces this combined rate to a more reasonable level, the same result could have been achieved by lowering the tax rate applicable to the investment income of a CCPC. Why did the government not adopt this less complex alternative?
7. What is the objective of the Additional Refundable Tax (ART) that is assessed under ITA 123.3? Briefly explain your conclusion.
8. What is the objective of the Part IV Refundable Tax on certain types of dividends received by a private company? Briefly explain your conclusion.
9. With respect to Part IV tax rules, what is a "subject corporation"? How does the Part IV legislation classify such companies?
10. What is a connected corporation? Under what circumstances will Part IV tax be applicable to dividends received from such corporations?
11. Describe the types of dividends on which Part IV tax is assessed.
12. A corporation can apply non-capital or farm losses to reduce the amount of Part IV tax payable. Would you recommend this procedure to a client?
13. List the components that make up the Refundable Dividend Tax On Hand (RDTOH) balance.
14. The first component of the formula for determining the refundable portion of Part I tax, 30-2/3 percent of aggregate investment income, is reduced by the amount, if any, by which the foreign non-business income tax credit exceeds 8 percent of its foreign investment income for the year. What objective is achieved by subtracting this amount?
15. For a CCPC earning investment income, there may be a refund of taxes paid when the company pays dividends. How is the amount of this refund determined?

16. A CCPC can only designate dividends as eligible to the extent that it has a GRIP balance. Indicate the two most common sources of additions to this balance.
17. What would be one of the most common additions to a public corporation's LRIP balance?
18. Briefly describe the calculation of the tax on excessive eligible dividend designations (EEDD) for a CCPC.
19. Briefly describe the calculation of the tax on excessive eligible dividend designations (EEDD) for a public company.

## **TIF PROBLEM THIRTEEN - 2**

### **Corporate Investment Income - True Or False**

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#### **New For 2016/2017**

1. For dividends received in a specific province, the after tax rates of return to investors are higher for eligible dividends received than for non-eligible dividends.  
True or False?
2. Dividends declared by public companies will always be eligible dividends.  
True or False?
3. As defined in ITA 129(4), aggregate investment income is reduced by any net capital losses that are deducted during the year.  
True or False?
4. The objective of the Additional Refundable Tax On Investment Income is to discourage the use of a Canadian controlled private corporation to defer taxes on investment income.  
True or False?
5. The Part IV tax is assessed on all of the dividends received from connected corporations.  
True or False?
6. An investee company can be designated as a connected company, even if the investor company does not have control.  
True or False?
7. The current year balance in the RDTOH account is reduced by dividends paid in the preceding year.  
True or False?
8. The dividend refund for the current year cannot exceed the balance in the RDTOH account at the end of the year.  
True or False?
9. If a Canadian controlled private corporation has a GRIP balance, it must designate any dividend that is paid as eligible until that balance is eliminated.  
True or False?
10. A Canadian controlled private corporation's GRIP balance is reduced by dividends that were designated as eligible in the preceding taxation year.  
True or False?

#### **Retained From Previous Editions**

11. The major goal of integration is to ensure that, if an individual has a given income source, he will retain the same after tax amount of cash from that source, without regard to whether he receives the income directly or, alternatively, the income is routed through a corporation prior to his ultimate receipt of the after tax amount.  
True or False?

*Corporate Investment Income - True Or False*

12. For integration to work properly for a CCPC whose income qualifies for the small business deduction, the combined federal/provincial tax rate on corporations must be equal to 14.53 percent, while the combined federal/provincial dividend tax credit must be equal to 21/29 of the gross up.

True or False?

13. A corporation's dividend refund for the year will be the lesser of the balance in the RDTOH account at the beginning of the year and 38-1/3 percent of the taxable dividends paid for the year.

True or False?

14. A CCPC's GRIP balance is increased by 72 percent of eligible dividends received during the year.

True or False?

**TIF PROBLEM THIRTEEN - 3****Corporate Investment Income - Multiple Choice**

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**New For 2016/2017****Integration**

1. Which of the following statements with respect to non-eligible dividends paid in 2016 is **NOT** correct?
  - A. Taxable dividends will be equal to 117 percent of dividends received.
  - B. Eligible dividends can be designated by both public corporations and CCPCs.
  - C. The combined federal/provincial dividend tax credit will always be equal to the gross up.
  - D. The federal dividend tax credit on such dividends is always equal to 21/29 of the gross up.

**Refundable Taxes on Investment Income**

2. As defined in ITA 129(4), aggregate investment income does **NOT** include:
  - A. Dividends from non-affiliated foreign corporations.
  - B. Net capital loss carry overs deducted in the current year.
  - C. Net taxable capital gains.
  - D. Dividends from taxable Canadian companies.

**Refundable Part I Tax On Investment Income**

3. With respect to the refundable Part I tax on investment income, which of the following statements is **NOT** correct?
  - A. It is always equal to 30-2/3 percent of aggregate investment income.
  - B. It is a designated portion of the regular Part I tax.
  - C. It is only applicable to Canadian controlled private corporations.
  - D. It only become refundable when dividends are paid.

**Refundable Part IV Tax On Dividends Received**

4. Which of the following statements with respect to Part IV tax is **NOT** correct?
  - A. All dividends from subject companies will be assessed Part IV tax.
  - B. All dividends from portfolio investments will be assessed Part IV tax.
  - C. Dividends from a connected company will be assessed Part IV tax if the paying company received a dividend refund.
  - D. Part IV tax is assessed at a rate of 30-2/3 percent.

**Refundable Dividend Tax On Hand (RDTOH)**

5. With respect to RDTOH account, which of the following statements is **NOT** correct?
  - A. The balance is reduced by 38-1/3 percent of any dividends paid during the year.
  - B. The balance is increased by 38-1/3 percent of any portfolio dividends received.
  - C. The dividend refund for the current year cannot exceed the balance in this account.
  - D. The balance is increased by the amount of the refundable Part I tax.

**Designation of Eligible Dividends**

6. With respect to GRIP and LRIP balances, which of the following statements is **NOT** correct?
- A. A CCPC's GRIP account is reduced by the amount of eligible dividends designated in the preceding taxation year.
  - B. A CCPC's GRIP account is increased by the amount of eligible dividends received during the current year.
  - C. A public company's LRIP account is increased by the amount of non-eligible dividends received.
  - D. A CCPC's GRIP account is increased by 72 percent of the company's Taxable Income.

**Retained From Previous Editions****Integration**

7. Which of the following statements with respect to eligible dividends paid in 2016 is **NOT** correct?
- A. The recipient individual shareholder must gross them up by 38 percent.
  - B. They generate a federal tax credit equal to 6/11 of the gross up.
  - C. They can only be designated as eligible dividends by public companies.
  - D. They can be designated as eligible dividends by CCPCs with a positive GRIP balance.
8. Which of the following types of dividends would not be subject to a gross up and would not generate a dividend tax credit to the individual shareholder who receives it?
- A. A stock dividend.
  - B. A capital dividend.
  - C. A deemed dividend.
  - D. A dividend in kind.
9. With respect to integration, which of the following statements is correct for 2016?
- A. For integration to be effective in situations where non-eligible dividends are paid, the combined federal/provincial tax rate on corporations must be equal to 27.54 percent.
  - B. For integration to be effective in situations where non-eligible dividends are paid, the provincial tax rate on individuals must be 14 percent.
  - C. For integration to be effective in situations where eligible dividends are paid, the provincial dividend tax credit must be equal to 21/29 of the dividend gross up.
  - D. For integration to be effective in situations where non-eligible dividends are paid, the combined federal/provincial tax rate on corporations must be equal to 14.53 percent.
10. For integration to work perfectly, two conditions must be met. For 2016, these two conditions are:
- A. The combined federal/provincial tax rate on corporations must equal 14.53% for eligible dividends and 27.54% for non-eligible dividends, and the combined federal and provincial dividend tax credits must equal the gross up.
  - B. The federal and provincial tax and dividend tax credit rates must be equal.
  - C. The combined federal/provincial tax rate on corporations must equal 14.53% for non-eligible dividends and 27.54% for eligible dividends, and the combined federal and provincial dividend tax credits must equal the gross up.
  - D. Both the corporate federal tax payable and the federal dividend tax credit must be equal to the gross up.

*Corporate Investment Income - Multiple Choice*

11. It is necessary for corporations to designate dividends that they pay as eligible dividends which are eligible for the enhanced gross up and dividend tax credit procedure because:
- Some CCPCs have some portion of their income taxed at full rates while some non-CCPCs will pay dividends out of income that has been taxed at lower rates.
  - Most CCPCs have all of their income taxed at low rates, and some non-CCPCs have only income that is taxed at lower rates.
  - All companies always have some portion of their income taxed at full rates.
  - Some non-CCPCs have income taxed at lower rates.
12. Integration works when the combined federal and provincial tax rate on corporate income is at a certain benchmark level for corporations paying eligible dividends and a different benchmark level for corporations paying non-eligible dividends. Applicable rates vary from province to province which affects the effectiveness of integration. If you assume that the combined federal/provincial dividend tax credit is equal to 100 percent of the gross up, which of the following statements is correct with respect to combined federal and provincial tax rates and the effectiveness of integration?
- If the combined corporate tax rate exceeds the benchmark rate, then the use of a corporation will result in lower taxation.
  - If the combined corporate tax rate is equal to the benchmark rate, then the use of a corporation will result in the same amount of taxation.
  - If the combined corporate tax rate is less than the benchmark rate, then the use of a corporation will result in additional taxation.
  - The combined corporate tax rate for corporations paying non-eligible dividends must be greater than the combined corporate tax rate for corporations paying eligible dividends for integration to work for all dividends.
13. Integration works when the combined federal and provincial dividend tax credit rate is at a certain benchmark level. Applicable dividend tax credit rates vary from province to province which affects the effectiveness of integration. If you assume that the combined federal/provincial corporate tax rate is at the benchmark rate for the type of dividend under consideration, which of the following statements is correct with respect to combined federal and provincial dividend tax credit rates and the use of a corporation?
- If the combined dividend tax credit rate is less than 100 percent of the gross up, then the use of a corporation will result in additional taxation.
  - If the combined dividend tax credit rate is greater than 100 percent of the gross up, then the use of a corporation will result in additional taxation.
  - The provincial dividend tax rate must be greater than the federal dividend tax rate for integration to work.
  - The combined dividend tax rate on non-eligible dividends must be greater than the combined dividend tax rate on eligible dividends for integration to work for all dividends.

**Refundable Taxes on Investment Income**

14. During the year, Makisha Fashions Inc has the following sources of income:

Taxable capital gains	\$45,000
Allowable capital losses	42,000
Dividends from taxable Canadian corporations	25,000
Dividends from non-affiliated foreign corporations	3,000

What is the total aggregate investment income?

- \$6,000
- \$31,000
- \$48,000
- \$73,000

*Corporate Investment Income - Multiple Choice*

15. A simple solution to the problem of high corporate tax rates on investment income would be to apply a different, lower corporate tax rate directly to this type of income. Instead, the Canadian tax system uses refundable taxes to lower the rate of taxation on investment income of CCPCs. Why?
- Lower rates would create a situation where the payment of dividends to shareholders would result in double taxation.
  - Lower rates would provide a significant deferral of taxes on investment income.
  - Refundable taxes encourage early filing of corporate tax returns.
  - Refundable taxes provide a reason to retain funds in the corporation.
16. Which of the following items would **NOT** influence the determination of aggregate investment income?
- Canadian source rental income.
  - Foreign source dividend income.
  - Net capital losses deducted.
  - Dividends from taxable Canadian corporations.

**Refundable Part I Tax On Investment Income**

17. During the current year, Norton Tools Ltd. has net taxable capital gains of \$45,000, receives dividends from taxable Canadian corporations of \$34,000, and earns interest income of \$21,000. Taxable Income for the year equals \$280,000, of which \$210,000 is eligible for the small business deduction. The Company's additional refundable tax for the year is equal to:
- \$ 7,467.
  - \$10,667.
  - \$ 7,040.
  - \$ 8,427.

18. During the year, Makisha Fashions Inc has the following sources of income:

Taxable capital gains	\$45,000
Allowable capital losses	42,000
Dividends from taxable Canadian corporations	25,000
Dividends from non-affiliated foreign corporations	3,000

The company has taxable income of \$495,000, of which \$200,000 was eligible for the small business deduction. What is the total Additional Refundable Tax on Investment Income (ART)?

- \$ 640
- \$3,307
- \$5,120
- \$7,787

## Corporate Investment Income - Multiple Choice

19. A Ltd. is a Canadian controlled private corporation that operates a chain of fast-food restaurants. In its most recent fiscal year, the Company had the following financial results:

Active business income eligible for the small business deduction	\$200,000
Taxable capital gains	Nil
Foreign investment income	55,000
Investment income earned in Canada	45,000
<hr/>	
Net Income For Tax Purposes	\$300,000
<hr/>	
<hr/>	
Taxable Income	\$250,000
<hr/>	
<hr/>	

The Company paid no foreign taxes on its foreign investment income. A Ltd. is not associated with any other corporations.

Which one of the following amounts represents the refundable portion of Part I tax?

- A. \$13,800.  
 B. \$15,333.  
 C. \$30,667.  
 D. \$76,667.
20. With respect to Part I refundable taxes, which of the following statements is correct?
- A. It is an additional tax which must be paid on aggregate investment income.  
 B. It is always refundable at the rate of 38-1/3 percent of dividends paid.  
 C. It is designed to prevent the deferral of taxes on investment income that is retained by a public company.  
 D. It is designed to prevent the deferral of taxes on investment income that is retained by a CCPC.
21. The refundable Part IV tax on dividends received is required in order to:
- A. Prevent tax deferral in situations where there are multiple levels of corporations in a corporate group.  
 B. Avoid double taxation of dividends paid to corporate shareholders.  
 C. Ensure proper integration on investment income at the corporate level.  
 D. Ensure that public companies pay out some dividends in every year they are profitable.
22. A subject corporation for purposes of Part IV tax is defined as:
- A. A resident private corporation that is controlled by an individual or for the benefit of an individual.  
 B. A resident public corporation that is controlled largely for the benefit of an individual or a related group of individuals.  
 C. A resident public corporation that is controlled, through trusts, largely for the benefit of an individual or related group of individuals.  
 D. A non-resident private corporation that is controlled largely for the benefit of a resident individual or related group of individuals.

**Refundable Part IV Tax On Dividends Received**

23. Premier Investments Inc. (Premier) is a private corporation. Premier received \$20,000 of dividends from its investments in publicly traded Canadian shares during its taxation year ended December 31, 2016. Premier has loss carry forwards as follows: non-capital losses of \$3,000, net capital losses of \$5,000, and farm losses of \$7,000. All of these losses are available for application in Premier's 2016 taxation year. The non-capital and farm losses will expire if not used during 2016. Assuming Premier has no other income, what is Premier's minimum 2016 Part IV Tax Payable?
- Nil.
  - \$1,917.
  - \$3,834.
  - \$7,667.
24. Opus Limited is a Canadian controlled private corporation. During 2016, the company received the following dividends:
- |  |           |
|--|-----------|
| Dividends on Portfolio Investments               | \$ 35,000 |
| Dividends from Magnum Inc. [(100%)(55,000)]      | 55,000    |
| Dividends from Masterpiece Ltd. [(40%)(100,000)] | 40,000    |
- Opus owns 100% of the shares of Magnum Inc. and 40% of the shares of Masterpiece Ltd. Masterpiece received a dividend refund of \$10,000 on its dividend payment, while Magnum received a dividend refund of \$15,000. Determine the amount of Part IV Tax payable by Opus Limited for the current year.
- \$29,417.
  - \$32,417.
  - \$38,417.
  - \$49,833.
25. CCPC Inc., a Canadian controlled private corporation, received a \$10,000 dividend from a non-connected public corporation, Payor Inc. Which of the following statements is correct?
- The dividends will be deductible by Payor Inc. from its RDTOH.
  - The dividend will be subject to a tax rate of 38-1/3%.
  - The dividend will be subject to Part I tax.
  - The dividend will be subject to Part IV tax if Payor Inc. received a dividend refund.
26. Mr. Patel is the sole owner of a holding company which owns 100 percent of the shares of his operating company that earns only active business income. Which of the following statements is correct?
- The holding company will pay Part IV tax on dividends received from the operating company.
  - Mr. Patel will receive dividends from the holding company tax free.
  - Mr. Patel will receive dividends from the operating company tax free.
  - The holding company will receive dividends from the operating company tax free.

**Refundable Dividend Tax On Hand (RDTOH)**

27. Schumann Inc. is a CCPC that has the following information for the current year:

Canadian active business income	\$140,000
Dividend from a taxable Canadian corporation	15,000
Aggregate investment income	60,000
Taxable income	200,000
Income eligible for the small business deduction	140,000
Part I tax payable for the year	21,900

The refundable portion of Part I tax for the year is equal to:

- A. \$5,750.
  - B. \$18,400.
  - C. \$24,150.
  - D. \$21,900.
28. Which of the following statements best describes the purpose of the dividend refund?
- A. The dividend refund allows corporations with a balance in their RDTOH account to reduce their tax payable by paying dividends.
  - B. The dividend refund allows corporations with a balance in their capital dividend account to reduce their tax payable by paying dividends.
  - C. The dividend refund reduces the effective tax rate on dividend income earned by corporations.
  - D. The dividend refund reduces the effective tax rate on dividend income earned by shareholders.
29. M&M Ltd. is a Canadian controlled private corporation. It does not hold any investments that pay dividends. Its refundable dividend tax on hand (RDTOH) account at December 31, 2015 was \$70,000. For its 2016 taxation year, its refundable portion of Part I tax was \$42,000. M&M Ltd. paid taxable dividends of \$120,000 in 2015 and \$150,000 in 2016.

The balance in M&M Ltd.'s RDTOH account at December 31, 2016 is:

- A. \$54,500
- B. \$70,000
- C. \$66,000
- D. \$112,000

**Designation of Eligible Dividends**

30. At the end of 2015, Gomez Inc., a CCPC, has a GRIP of \$53,400. For 2016, the Company has Taxable Income of \$143,000. This includes aggregate investment income of \$19,000. In addition, the Company receives eligible dividends of \$12,300. In calculating 2016 Tax Payable, the Company has a small business deduction of \$14,875. During 2015, the company paid dividends of \$42,000 with \$13,700 of the dividends designated as eligible. Dividends paid during 2016 total \$51,000, with \$18,400 of this amount being designated as eligible. What is the amount of the Company's GRIP at the end of the 2016 taxation year?

- A. \$80,080
- B. \$93,780
- C. \$67,780
- D. \$75,380

31. With respect to GRIP and LRIP balances, which of the following statements is correct?
- A. The GRIP account is used to track balances that can be used by a CCPC as the basis for designating eligible dividends.
  - B. The GRIP account is used to track balances that have not been subject to full corporate tax rates.
  - C. The LRIP account is used to track balances that can be used by any company as the basis for designating non-eligible dividends.
  - D. The LRIP account is used to track balances that can be used by non-CCPCs as the basis for designating eligible dividends.
32. A non-CCPC has an LRIP balance of \$78,000 at the end of the 2015 fiscal year. In 2016, the company wishes to pay a dividend of \$250,000. During 2016, prior to the payment of the dividend, the company receives eligible dividends of \$35,000 and non-eligible dividends of \$85,000. How much of the \$250,000 dividend must be paid as a non-eligible dividend before an eligible dividend can be designated?
- A. \$ 78,000
  - B. \$ 113,000
  - C. \$ 163,000
  - D. \$ 250,000

**TIF PROBLEM THIRTEEN - 4****Corporate Investment Income - Exam Exercises**

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**Exam Exercise Subject Listing For Chapter 13**

<b>Number</b>	<b>Subject</b>
1	Integration - Non-Eligible Dividends
2	Integration - Non-Eligible Dividends
3	Integration - Eligible Dividends
4	Integration - Eligible Dividends
5	Additional Refundable Tax On Investment Income
6	Additional Refundable Tax On Investment Income
7	Flow Through Of Investment Income
8	Flow Through Of Investment Income
9	Part IV Tax
10	Part IV Tax
11	Refundable Part I Tax
12	Refundable Part I Tax
13	RDTOH Balance
14	Dividend Refund
15	Dividend Refund
16	GRIP Balance
17	GRIP Balance

**Exam Exercise Thirteen - 1 (Integration - Non-Eligible Dividends)**

Patrick Innes has a business that he estimates will produce income of \$130,000 per year. If he incorporates this business in 2016, all of the income would be eligible for the small business deduction and all dividends paid would be non-eligible. In the province where he lives, such corporate income is taxed at a combined federal/provincial rate of 14 percent. Mr. Innes has other income sources that place him in a combined federal/provincial tax bracket of 42 percent. In his province, the provincial dividend tax credit for non-eligible dividends is equal to 20 percent of the gross up.

Would Mr. Innes save taxes if he was to channel this source of income through a corporation? Explain your result.

**Exam Exercise Thirteen - 2 (Integration - Non-Eligible Dividends)**

Nashwa has a business that she estimates will produce annual income of \$100,000. She is planning to incorporate this business in 2016, and if she does, all of the income will be eligible for the small business deduction and all dividends paid will be non-eligible. In her province, such corporate income is taxed at a combined federal/provincial rate of 15 percent. Nashwa is taxed at a combined federal/provincial rate of 43 percent. The provincial dividend tax credit rate for non-eligible dividends is equal to 29 percent of the gross up.

Would Nashwa save taxes if she was to channel this source of income through a corporation? Explain your result.

**Exam Exercise Thirteen - 3 (Integration - Eligible Dividends)**

Janice Huber has a business that she estimates will produce income of \$75,000 per year. Because she controls another corporation that fully utilizes \$500,000 of its small business deduction, if she incorporates this business, none of this income will be eligible for the small business deduction and any dividends paid would be designated eligible. In the province where she lives, such corporate income is taxed at a combined federal/provincial rate of 28 percent. Ms. Huber has other income sources that place her in a combined federal/provincial tax bracket of 46 percent. In her province, the provincial dividend tax credit for eligible dividends is equal to 32 percent of the gross up.

Would Ms. Huber save taxes if she was to channel this source of income through a corporation? Explain your result.

**Exam Exercise Thirteen - 4 (Integration - Eligible Dividends)**

Florence has a business that she estimates will produce income of \$100,000. She is planning to incorporate this business in 2016, and if she does, none of the income will be eligible for the small business deduction because she controls a corporation that fully utilizes the \$500,000 small business deduction. As a result, all dividends paid will be designated eligible. In her province, such corporate income is taxed at a combined federal/provincial rate of 29 percent. Florence has income from other sources that will result in any additional income being taxed at a combined federal/provincial rate of 43 percent. The provincial dividend tax credit rate on eligible dividends is equal to 29 percent of the gross up.

Would Florence save taxes if she was to channel this source of income through a corporation? Explain your result.

**Exam Exercise Thirteen - 5 (Additional Refundable Tax On Investment Income)**

Axco Inc. is a CCPC with a December 31 year end. Axco is not associated with any other company. For the 2016 taxation year, its Net Income For Tax Purposes is equal to \$342,000. This is made up of active business income of \$226,000, dividends from taxable Canadian corporations of \$31,000, taxable capital gains of \$51,000 and interest income on long-term investments of \$34,000. The Company has available a net capital loss carry forward of \$32,000 [(1/2)(\$64,000)] and a non-capital loss carry forward of \$29,000. The Company intends to deduct both of these carry forwards in the 2016 taxation year.

Determine Axco's Taxable Income and its additional refundable tax on investment income for the 2016 taxation year.

**Exam Exercise Thirteen - 6 (Additional Refundable Tax On Investment Income)**

Barnum Ltd. is a CCPC with a December 31 year end. For the 2016 taxation year, the Company has a Net Income For Tax Purposes of \$436,000. This is made up of active business income of \$256,000, dividends from taxable Canadian corporations of \$61,000, taxable capital gains of \$85,000, and interest income on long-term investments of \$34,000. In filing its 2016 tax return, the company will deduct a non-capital loss carry forward of \$163,000, and a net capital loss carry forward of \$47,000. Barnum is associated with one other company and they have agreed to split the annual business limit on a 50/50 basis.

Determine Barnum's Taxable Income and its additional refundable tax on investment income for the 2016 taxation year.

**Exam Exercise Thirteen - 7 (Flow Through Of Investment Income)**

Mr. Marcus Fisher has investments that generate interest income of \$94,000 per year. Because of his employment income, he is in the top tax bracket, with a combined federal/provincial rate of 52 percent. He is considering the transfer of these investments to his CCPC which would be subject to a tax rate on investment income of 51 percent. The dividend tax credit in his province is equal to 30 percent of the gross up. Any dividends paid by the CCPC out of investment income will be non-eligible. Advise him as to whether there would be any tax benefits associated with this transfer.

**Exam Exercise Thirteen - 8 (Flow Through Of Investment Income)**

Marion Fox has investments that generate interest income of \$172,000 each year. She also has employment income in excess of \$200,000 per year. This places her firmly in the top tax bracket, with a combined federal provincial rate of 53 percent.

She is considering transferring her interest bearing investments to a newly incorporated CCPC. In her province, the combined federal/provincial rate on the investment income of CCPCs is 50 percent. All of the corporation's income would be paid out as non-eligible dividends. The provincial dividend tax credit rate on non-eligible dividends is 35 percent of the gross up.

Advise Marion as to whether there would be any tax benefits associated with this transfer.

**Exam Exercise Thirteen - 9 (Part IV Tax)**

Overton Ltd. is a Canadian controlled private corporation. During 2016, the Company received the following amounts of dividends:

Dividends On Various Portfolio Investments	\$21,300
Dividends From Saston Inc. [(100%)(62,300)]	62,300
Dividends From Raston Inc. [(40%)(90,000)]	36,000

Overton Ltd. owns 100 percent of the voting shares of Saston Inc. and 40 percent of the voting shares of Raston Inc. The fair market value of the Raston Inc. shares equals 40 percent of the fair market value of all Raston Inc. shares. As a result of paying the \$90,000 dividend, Raston Inc. received a dividend refund of \$25,000. Saston Inc. received no dividend refund for its dividend payment.

Determine the amount of Part IV Tax Payable by Overton Ltd. as a result of receiving these dividends.

**Exam Exercise Thirteen - 10 (Part IV Tax)**

Blackwood Inc. is a Canadian controlled private company. It has two subsidiaries. Information related to these subsidiaries is as follows:

**Whitewood Ltd.** Blackwood owns 65 percent of Whitewood Ltd. During 2016, Whitewood paid total dividends of \$100,000. Whitewood received a dividend refund of \$20,000 as a result of paying these dividends.

**Redwood Inc.** Blackwood owns 100 percent of Redwood Inc. During 2016, Redwood paid total dividends of \$72,000. No dividend refund was received as a result of paying these dividends.

In addition to the dividends received from subsidiaries, Blackwood received \$35,000 in dividends from various portfolio investments.

Determine the amount of Part IV Tax Payable by Blackwood Inc. as a result of receiving these dividends.

**Exam Exercise Thirteen - 11 (Refundable Part I Tax)**

Starfare Ltd. is a Canadian controlled private corporation. During the taxation year ending December 31, 2016, the Company has the following amounts of property income:

Net Rental Income	\$17,600
Capital Gains	91,500
Dividends From Portfolio Investments	41,300
Interest On Long-Term Investments	17,450
Foreign Non-Business Income - Net Of 8 Percent Withholding	18,400

The Company's 2016 Net Income For Tax Purposes is \$232,350. The Company has available a net capital loss carry forward of \$24,000 [(1/2)(48,000)], which is deducted from Taxable Income. A \$13,125 small business deduction and a foreign non-business tax credit of \$1,600 served to reduce Tax Payable. Assume that the Company's Part I Tax Payable has been correctly determined to be \$38,258. Determine the refundable amount of Part I tax for the year ending December 31, 2016.

**Exam Exercise Thirteen - 12 (Refundable Part I Tax)**

Elm Inc. is a Canadian controlled private corporation. During the taxation year ending December 31, 2016, the Company has the following amounts of property income:

Interest On Long Term Investments	\$33,000
Taxable Capital Gains	88,000
Dividends From Portfolio Investments	83,000
Net Rental Income	26,000
Foreign Non-Business Income (Before 10 Percent Withholding)	40,000

The Company's 2016 Net Income For Tax Purposes is \$458,000. In calculating Taxable Income, the Company deducted a \$45,000 net capital loss carry forward.

In calculating Tax Payable, the Company deducted a small business deduction of \$21,875 and a foreign non-business tax credit of \$4,000. The Tax Payable has been correctly determined to be \$73,482.

Determine the refundable amount of Part I tax for the year ending December 31, 2016.

**Exam Exercise Thirteen - 13 (RDTOH Increase For The Year)**

Schumann Inc. is a CCPC that earned \$60,000 in foreign investment income during 2016 as well as Canadian active business income. The foreign government withholds 10 percent of this amount, and as a result, Schumann receives a foreign non-business tax credit of \$6,000. Taxable income for 2016 is \$200,000 with \$140,000 eligible for the small business deduction. Assume the Part I tax payable for the year is \$31,900. Determine the amount of the increase to the RDTOH account for the year.

**Exam Exercise Thirteen - 14 (Dividend Refund)**

Ho Trading Company is a Canadian controlled private corporation with a December 31 year end. At December 31, 2015, it had an RDTOH account balance of \$43,500. As a result of paying dividends during 2015, the Company received a refund of \$6,000. During 2016, Ho Trading Company's only income is \$43,000 in taxable capital gains and \$12,350 in dividends received from a temporary investment in Royal Bank shares. During 2016, the Company declares and pays a \$35,000 dividend on its common shares. Determine the Company's dividend refund for 2016.

**Exam Exercise Thirteen - 15 (Dividend Refund)**

Amadeus Corp. has a balance at December 31, 2015 in its RDTOH account of \$15,000. In 2015, as a result of paying taxable dividends, they received a dividend refund of \$12,000. In 2016 they paid taxable dividends of \$39,000. In 2016, the company correctly determines that they have \$2,000 in refundable Part I tax, before any refunds. Dividend income from portfolio dividends was \$18,000 in 2016. How much of a dividend refund will the company receive in 2016?

**Exam Exercise Thirteen - 16 (GRIP Balance)**

Simard Ltd., a CCPC, had no GRIP balance at its year end on December 31, 2014. During 2015, the Company received eligible dividends of \$167,000 and designated \$153,000 of its dividends paid as eligible. At the end of 2015, Simard has a GRIP of \$167,000.

For 2016, Simard has Taxable Income of \$476,000. This amount includes taxable capital gains of \$14,000, interest income on long-term bonds of \$7,000, and a net capital loss deduction of \$14,000. In addition, the Company receives eligible dividends during the year of \$17,000. In determining 2016 Tax Payable, the Company has a small business deduction of \$70,000. During 2016, Simard Ltd. pays dividends of \$25,000, with \$18,000 of this amount being designated as eligible.

Determine the Company's GRIP balance at the end of 2016.

**Exam Exercise Thirteen - 17 (GRIP Balance)**

Saxon Company is a CCPC that began operations on January 1, 2015. It has adopted a December 31 year end.

During 2015, the Company received eligible dividends of \$320,000 and designated \$290,000 of the dividends it paid as eligible. On December 31, 2015, the balance in the Company's GRIP account was \$375,000.

For 2016, Saxon has Taxable Income of \$726,000. Included in this amount is \$18,000 of interest income, taxable capital gains of \$22,000, and the deduction of a net capital loss of \$18,000. Also during that year, the Company received eligible dividends of \$36,000. In determining the 2016 Tax Payable, the Company has a small business deduction of \$61,250. During 2016, Saxon pays dividends of \$48,000, with \$21,000 of this amount being designated as eligible.

Determine the Company's GRIP balance at the end of 2016.

## TIF PROBLEM THIRTEEN - 5A

### Corporate Investment Income - Key Term Matching (Easy)

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 13, "Taxation Of Corporate Investment Income".

- A. Additional Refundable Tax On Investment Income
- B. Aggregate Investment Income
- C. Excessive Eligible Dividend Designation
- D. General Rate Income Pool
- E. Part IV Tax
- F. Portfolio Dividend
- G. Refundable Dividend Tax On Hand
- H. Integration

The following list contains ten potential definitions for the preceding key terms.

1. An approach to the taxation of corporations that attempts to ensure that amounts of income that are flowed through a corporation to its individual shareholders, are subject to the same amount of tax as would be the case if the individuals had received the income directly from its source.
2. A dividend received from a corporation to which the recipient is not connected.
3. A balance that includes net taxable capital gains for the year reduced by any net capital loss carry overs deducted in the year, plus interest income, rents, and royalties.
4. A balance, subject to Part III.1 tax, which reflects an inappropriate designation of an amount of dividends paid as an eligible dividend.
5. A refundable tax, applicable to private corporations and subject corporations, and assessed on portfolio dividends received as well as some dividends received from connected corporations.
6. A notional account that tracks amounts of a non-CCPC's income that cannot be used for the payment of eligible dividends.
7. A balance made up of refundable taxes paid, less refunds received as the result of paying dividends.
8. A notional account that tracks amounts of a CCPC's income that can be used for the payment of eligible dividends.
9. The portion of Part I tax that is applicable to a notional amount of aggregate investment income earned by a CCPC.
10. A 10-2/3 percent tax on the aggregate investment income of a CCPC.

*Corporate Investment Income - Key Term Matching (Easy)*

11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM THIRTEEN - 5B****Corporate Investment Income - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 13, "Taxation Of Corporate Investment Income".

- Additional Refundable Tax On Investment Income
- Aggregate Investment Income
- Excessive Eligible Dividend Designation
- General Rate Income Pool
- Part IV Tax
- Portfolio Dividend
- Refundable Dividend Tax On Hand
- Integration

The following list contains 14 potential definitions for the preceding key terms.

1. An approach to the taxation of corporations that attempts to ensure that amounts of income that are flowed through a corporation to its individual shareholders, are subject to the same amount of tax as would be the case if the individuals had received the income directly from its source.
2. A dividend received from a corporation to which the recipient is not connected.
3. A notional account that tracks amounts of a private company's income that can be used for the payment of eligible dividends.
4. A balance that includes net taxable capital gains for the year reduced by any net capital loss carry overs deducted in the year, plus interest income, rents, and royalties.
5. A balance, subject to Part III.1 tax, which reflects an inappropriate designation of an amount of dividends paid as an eligible dividend.
6. A refundable tax, applicable to private corporations and subject corporations, and assessed on portfolio dividends received as well as some dividends received from connected corporations.
7. A dividend received from a corporation to which the recipient is not associated.
8. A notional account that tracks amounts of a non-CCPC's income that cannot be used for the payment of eligible dividends.
9. A balance made up of refundable taxes paid, less refunds received as the result of paying dividends.
10. A notional account that tracks amounts of a CCPC's income that can be used for the payment of eligible dividends.

*Corporate Investment Income - Key Term Matching (Moderate)*

11. A balance that includes net taxable capital gains for the year reduced by any net capital loss carry overs deducted in the year, interest income, rents, and dividends received from Canadian corporations.
12. The portion of Part I tax that is applicable to a notional amount of aggregate investment income earned by a CCPC.
13. A 10-2/3 percent tax on the aggregate investment income of a CCPC.
14. A refundable tax, applicable to Canadian controlled private corporations, and assessed on portfolio dividends received as well as some dividends received from connected corporations.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## TIF PROBLEM THIRTEEN - 6

### Integration Example

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Assume the following with respect to the shareholder of a CCPC who is an individual.

- The corporation's business income for the year is \$80,000.
- Any dividends paid are designated non-eligible dividends.
- The individual's marginal federal tax rate is 26 percent and his marginal provincial tax rate is 8 percent.
- The provincial dividend tax credit on non-eligible dividends is equal to 20 percent of the gross up.
- The combined federal and provincial corporate tax rate on business income is 13 percent.

**Required:** Indicate, using these assumptions, whether integration is working perfectly. If your answer is no, briefly explain why this is the case.

## **TIF PROBLEM THIRTEEN - 7**

### **Part I And Part IV Refundable Taxes**

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Warron Inc. is a Canadian controlled private corporation. It has a December 31 year end. The following information relates to its 2016 taxation year.

1. At the end of 2015, the Company's Refundable Dividend Tax On Hand balance was \$19,400. The 2015 dividend refund was \$7,100.
2. Warron Inc. paid taxable dividends of \$53,250 during the year.
3. Warron Inc. owns 35 percent of the voting shares of Delux Inc., another CCPC with a December 31 year end. During 2016, Delux Inc. paid taxable dividends of \$48,600. As a consequence of paying these dividends, Delux Inc. received a dividend refund of \$14,400.
4. Warron Inc. is associated with several other corporations. Warron has been allocated \$64,000 of the associated group's annual business limit. This amount is significantly less than the Company's active business income for 2016.
5. During 2016, Warron Inc. has Taxable Income of \$365,100. Assume that Part I Tax Payable for the year was correctly calculated to be \$69,440. These totals do not include any foreign source income and no net capital losses were deducted during the year.
6. Other income that was reported by Warron Inc. consisted of the following amounts:

Capital Gain	\$71,200
Eligible Dividends From Power Corporation Preferred Shares	19,200
Net Rental Income From Residential Properties	13,200

**Required:** For the taxation year ending December 31, 2016, determine the Part IV and refundable Part I taxes that will be payable by Warron Inc. In addition, determine the balance in the Refundable Dividend Tax On Hand account at December 31, 2016, and any dividend refund available. Show all of the calculations used to provide the required information, including those for which the result is nil.

## **TIF PROBLEM THIRTEEN - 8**

### **Simple Corporate Tax Payable With ART**

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Epic Inc. is a Canadian controlled private corporation with a December 31 year end. The following information is available for the year ending December 31, 2016.

1. The Company had Canadian source active business income of \$237,000. Of this total, it was determined that \$126,000 qualified as manufacturing and processing profits under ITR 5200.
2. During 2016, the Company received \$25,500 in foreign investment income. This was net of \$4,500 that was withheld in the foreign jurisdiction.
3. The 2016 Net Income For Tax Purposes is equal to \$277,000. This is made up of the \$237,000 in active business income, the \$30,000 in foreign investment income, and \$10,000 in taxable capital gains.
4. Because of a \$50,000 non-capital loss that was carried forward, Taxable Income for 2016 is equal to \$227,000.
5. The Company shares the annual business limit for the small business deduction with two other companies. Epic's share of this limit is \$200,000.
6. Assume that the tax credit for foreign investment income is equal to the amount withheld.

**Required:** Calculate the federal Part I Tax Payable for the taxation year ending December 31, 2016. As the corporation operates in a province that has a reduced tax rate for M&P activity, a separate calculation of the federal M&P deduction is required. Show all of the calculations used to provide the required information, including those for which the result is nil.

**TIF PROBLEM THIRTEEN - 9****Part I And Part IV Refundable Taxes With GRIP**

Fracto Inc. is a Canadian controlled private corporation with a December 31 year end. For the taxation year ending December 31, 2016, its Net Income For Tax Purposes was made up of the following components:

Active Business Income (Note 1)	\$ 514,400
Dividends From Canadian Corporations:	
Wholly-Owned Subsidiary (Note 2)	297,400
Portfolio Investments (All Eligible Dividends)	89,600
Canadian Source Interest	44,300
Taxable Capital Gains	93,100
<b>Net Income For Tax Purposes</b>	<b>\$1,038,800</b>

**Note 1** As determined under ITR 5200, \$326,000 of this total qualified as M&P profits. As these amounts are allocated to a province which has a special rate for M&P profits, the company calculates the federal M&P deduction.

**Note 2** As a result of paying these dividends, the subsidiary received a dividend refund of \$52,800. None of these dividends were designated as eligible.

**Other Information:**

1. Fracto Inc. is part of a group of several associated companies. It has been agreed that Fracto Inc. will be allocated \$100,000 of the group's annual business limit for purposes of determining the small business deduction.
2. At December 31, 2015, Fracto Inc. had a Refundable Dividend Tax On Hand balance of \$12,000. During 2015, Fracto Inc. paid no dividends.
3. At December 31, 2015, Fracto Inc. had a GRIP balance of \$26,700.
4. On July 1, 2016, Fracto Inc. paid taxable dividends to its shareholders in the amount of \$132,400. Of this total, \$42,600 was designated as eligible.
5. The Company has available a net capital loss carry forward of \$12,000  $[(1/2)(\$24,000)]$  and a non-capital loss carry forward of \$163,400. It plans to deduct both of these items to the extent possible during 2016.

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

For Fracto Inc.'s 2016 taxation year, calculate the following items:

- A. Federal Part I Tax Payable.
- B. Part IV Tax Payable.
- C. The balance in the Refundable Dividend Tax On Hand account on December 31, 2016.
- D. The balance in the GRIP account on December 31, 2016.
- E. The dividend refund, if any.
- F. Federal Tax Payable (net of any dividend refund).

## **TIF PROBLEM THIRTEEN - 10**

### **Part I And Part IV Refundable Taxes**

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Conrod Holdings Ltd. is a Canadian controlled private corporation that sells farm supplies. It owns 70 percent of the outstanding shares of Morsal Inc. On November 1, 2016, Morsal Inc. declared and paid a dividend of \$21,000, of which Conrod Holdings Ltd. received \$14,700 (70 percent). As a result of paying the \$21,000 dividend, Morsal Inc. received a dividend refund in the amount of \$8,050.

Other income that was reported by Conrod Holdings consisted of the following amounts:

Capital Gain	\$9,200
Dividends From Imperial Oil Common Shares	500
Interest	450

The capital gain was on the sale of land that was formerly used as a storage area for inventories. Improved inventory control procedures have eliminated the need for this land.

The interest is on deposits of temporary cash balances set aside for the purchase of inventories.

At the end of 2015, the Company's Refundable Dividend Tax On Hand balance was \$8,950. The 2015 dividend refund was \$4,000.

The Company's Taxable Income for the year ending December 31, 2016 was \$44,000. No foreign income was included in this total. Assume the Part I Tax Payable for the year ending December 31, 2016 was correctly calculated as \$9,250. Because of its association with Morsal Inc., its share of the annual business limit on income eligible for the small business deduction is \$10,000. Conrod's active business income is equal to its share of the annual business limit.

Conrod Holdings paid taxable dividends of \$10,000 during 2016.

**Required:** Show all of the calculations used to provide the required information, including those for which the result is nil. For the taxation year ending December 31, 2016, calculate the following items for Conrod Holdings:

- A. Part IV Tax Payable.
- B. Refundable Part I Tax.
- C. The balance in the Refundable Dividend Tax On Hand account on December 31, 2016.
- D. The dividend refund, if any.

**TIF PROBLEM THIRTEEN - 11****Simple Part I With SBD, ART, FTC, M&P And GRR**

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The following data is for Masterson Ltd., a Canadian controlled private corporation. The data is for the taxation year ending December 31, 2016:

Canadian Source Active Business Income (Includes \$99,000 Of Manufacturing And Processing Profits)	\$133,000
Foreign Investment Income (Net Of \$1,200 In Withheld Foreign Taxes)	6,800
Net Income For Tax Purposes (Division B Income)	141,000
Taxable Income	95,000

No net capital loss carry forwards were deducted during 2016.

Assume that the tax credit on foreign investment income is equal to the \$1,200 in taxes withheld.

**Required:** Calculate the federal Part I Tax Payable for the taxation year ending December 31, 2016. Show all of the calculations used to provide the required information, including those for which the result is nil. Because Masterson operates in a province that has a special rate for M&P profits, a separate calculation of the M&P deduction is required.

**TIF PROBLEM THIRTEEN - 12****Part I Tax With SBD, ART, FTC, M&P, And GRR**

Landor Ltd. is a Canadian controlled private corporation. For the taxation year ending December 31, 2016, its Net Income For Tax Purposes has been correctly calculated as \$223,500. The components of this income are as follows:

Canadian Active Business Income (Note One)	\$183,450
Taxable Capital Gains	11,250
Foreign Business Income (Note Two)	28,800
Net Income For Tax Purposes	\$223,500

**Note One** This includes \$146,700 of manufacturing and processing profits, determined using the formula in the Income Tax Regulations.

**Note Two** This amount is before withholding by tax authorities in the foreign jurisdiction of 10 percent.

**Other Information:**

1. During 2016, Landor Ltd. declares and pays taxable dividends of \$46,000.
2. It is estimated that 88 percent of Landor's wages and 92 percent of Landor's sales are associated with permanent establishments located in a Canadian province.
3. The balance in Landor Ltd.'s Refundable Dividend Tax On Hand (RDTOH) account was nil on December 31, 2015. Landor paid no dividends in 2015.
4. At the beginning of 2016, Landor has available a net capital loss carry forward of \$5,250 [(1/2)(\$10,500)].
5. Landor Ltd. is associated with another company. They have agreed that Landor's share of the annual business limit will be \$110,000.
6. Assume that the foreign tax credit on foreign business income is equal to the amount withheld.

**Required:** Calculate Landor Ltd.'s minimum federal Tax Payable, net of any available dividend refund, for the year ending December 31, 2016. As the corporation operates in a province that has a reduced tax rate for M&P activity, a separate calculation of the federal M&P deduction is required. Show all of the calculations used to provide the required information, including those for which the result is nil.

**TIF PROBLEM THIRTEEN - 13****Tax Payable With SBD, ART, M&P, FTC, GRR, And GRIP**

Gardner Distributing Company, a Canadian controlled private corporation, was established ten years ago by Mr. Hugh Gardner. Its only business activity is the distribution of specialty gardening products to retailers across Canada. Mr. Gardner is a Canadian resident and is the sole shareholder of the Company. The Company has a fiscal year ending on December 31, and, for 2016, the Company's accountant produced the following Income Statement:

Sales Revenue		\$1,900,000
Cost Of Goods Sold		( 940,000)
<hr/>		
Gross Profit		\$ 960,000
Operating Expenses:		
Selling And Administration	(\$315,000)	
Amortization Expense	( 47,000)	
Charitable Donations	( 15,000)	( 377,000)
<hr/>		
Operating Income		\$ 583,000
Other Income And Losses:		
Eligible Dividends Received	\$ 27,000	
Loss On Sale Of Truck	( 19,000)	
Gain On Sale Of Investments	7,000	15,000
<hr/>		
Pre-Tax Accounting Income		\$ 598,000
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**Other information:**

- The Company had depreciable assets with the following undepreciated capital cost (UCC) balances at the beginning of its 2016 taxation year:

	UCC
Class 3 (5%)	\$726,000
Class 8 (20%)	472,000
Class 10 (30%)	22,000

The balance in Class 10 reflects a single truck that was used for deliveries. It had an original cost of \$38,000 and a net book value for accounting purposes of \$29,000. It was sold in 2016 for \$10,000, and replaced with a leased truck.

The only other transaction involving depreciable assets during the year was the acquisition of \$82,000 in Class 8 assets.

- On December 31, 2015, the Company had a balance in its Refundable Dividend Tax On Hand account of \$19,000. The Company claimed a dividend refund of \$5,000 in its 2015 corporate tax return.
- At the end of 2015, Gardner has a GRIP balance of \$32,500. During 2015, the Company designated \$9,600 of its dividends as eligible.
- During 2016, the Gardner Distributing Company paid \$17,000 in dividends to Mr. Gardner. All of these dividends were designated as eligible.
- The investments that were sold during the year had been purchased for \$93,000. They were sold for \$100,000.

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

*Tax Payable With SBD, ART, M&P, FTC, GRR, And GRIP*

- A. Determine Gardner Distributing Company's minimum Net Income For Tax Purposes and Taxable Income for the year ending December 31, 2016.
- B. Determine Gardner Distributing Company's Part I federal Tax Payable for the year ending December 31, 2016.
- C. Determine the December 31, 2016 balance in the Gardner Distributing Company's Refundable Dividend Tax On Hand account.
- D. Determine Gardner Distributing Company's minimum federal Tax Payable for the year ending December 31, 2016. This should include both Part I and Part IV Tax Payable, net of any dividend refund.
- E. Determine the December 31, 2016 balance in Gardner Distributing Company's GRIP.

**TIF PROBLEM THIRTEEN - 14****Tax Payable With SBD, ART, M&P, FTC, GRR, And GRIP**

Glandly Inc. is a Canadian controlled private corporation throughout its taxation year ending December 31, 2016. Its Net Income For Tax Purposes for the year is \$563,000. The components of this total are as follows:

Foreign Business Income (Before Foreign Taxes Withheld)	\$ 83,000
Foreign Non-Business Income (Before Foreign Taxes Withheld)	18,000
Eligible Dividends From Non-Connected Corporations	22,670
Non-Eligible Dividends From Wholly-Owned Subsidiary (The Subsidiary Received A Refund Of \$6,000 On Payment)	21,600
Net Taxable Capital Gains	38,250
Manufacturing And Processing Profits (From ITR 5200 Formula)	184,230
Other Canadian Active Business Income	117,100
Canadian Source Interest Income	78,150
<u>Net Income For Tax Purposes</u>	<u>\$563,000</u>

**Other Information:**

1. During 2016, Glandly Inc. declared and paid dividends of \$162,000. Of this total, \$24,000 was designated as eligible dividends.
2. Glandly Inc. makes donations to registered charities during 2016 in the amount of \$49,500.
3. Using the formula described in ITR 402, it has been determined that 87 percent of Glandly Inc.'s Taxable Income was earned in a Canadian province.
4. Glandly Inc. has available a net capital loss balance of \$45,000 [(1/2)(\$90,000)] and a non-capital loss balance of \$10,200. Management has indicated that they would like to deduct as much of these amounts as possible in the 2016 tax return.
5. Glandly Inc. is associated with two other Canadian controlled private corporations. They have agreed to allow Glandly to claim \$120,000 of the total annual business limit.
6. The December 31, 2015 balance in the Refundable Dividend Tax On Hand (RDTOH) account was \$193,500. The dividend refund for the year ending December 31, 2015 was \$47,300.
7. At the end of 2015, Glandly has a GRIP of \$32,400. During 2015, the company designated \$26,800 of its dividends as eligible.
8. The foreign jurisdiction withheld \$4,150 for the foreign business income and \$4,500 for the foreign non-business income. Assume the foreign tax credits for business and non-business income are equal to the amounts withheld.

*Tax Payable With SBD, ART, M&P, FTC, GRR, And GRIP*

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

- A. Determine Glandly Inc.'s minimum Taxable Income for the year ending December 31, 2016. Indicate the type and amount of any balances available for carry forward to subsequent years.
- B. Determine Glandly Inc.'s Part I Tax Payable for the year ending December 31, 2016. As the corporation operates in a province that has a reduced tax rate for M&P activity, a separate calculation of the federal M&P deduction is required. In making the required calculations here, assume that in Part A you calculated Glandly Inc.'s Taxable Income to be \$420,780 (this may or may not be the correct answer).
- C. Determine Glandly Inc.'s Part IV Tax Payable for the year ending December 31, 2016.
- D. Determine the December 31, 2016 balance in Glandly Inc.'s Refundable Dividend Tax On Hand (RDTOH) account.
- E. Determine Glandly Inc.'s dividend refund for the year ending December 31, 2016.
- F. Determine the December 31, 2016 balance in Glandly's GRIP.

**TIF PROBLEM THIRTEEN - 15****Tax Payable With SBD, ART, M&P, FTC, GRR, And GRIP**

B & C Limited is a Canadian controlled private corporation throughout its taxation year ending December 31, 2016. For that year, its Net Income For Tax Purposes and Taxable Income can be calculated as follows:

Canadian Manufacturing And Processing Profits As Per ITR 5200 Formula	\$123,000
Other Canadian Active Business Income	78,000
Canadian Source Interest Income	10,000
Canadian Source Taxable Capital Gains	24,000
Foreign Non-Business Income (Before \$3,000 Withholding)	20,000
Foreign Business Income (Before \$6,000 Withholding)	40,000
Eligible Portfolio Dividends	26,000
<b>Net Income For Tax Purposes</b>	<b>\$321,000</b>
Eligible Portfolio Dividends	( 26,000)
Charitable Donations	( 32,000)
Net Capital Loss Carry Forward	( 18,000)
<b>Taxable Income</b>	<b>\$245,000</b>

**Other Information:**

1. B & C Limited declared and paid taxable dividends of \$124,000 during 2016. Of this total, \$66,000 was designated as eligible.
2. It has been determined that 91 percent of B & C Limited's Taxable Income can be allocated to a Canadian province.
3. The December 31, 2015 balance in the Refundable Dividend Tax On Hand account was \$132,000. The dividend refund for the year ending December 31, 2015 was \$28,000.
4. At the end of 2015, B & C Ltd. has a GRIP of \$114,000. During 2015, the company designated \$72,000 of its dividends paid as eligible.
5. B & C Limited is associated with another Canadian controlled private corporation. B & C Limited has been allocated \$100,000 of the annual business limit.
6. Assume that the foreign tax credits for the foreign business and non-business income are equal to the amounts withheld.

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

- A. Determine B & C Limited's minimum federal Part I Tax Payable for the year ending December 31, 2016.
- B. Determine the December 31, 2016 balance in the Refundable Dividend Tax On Hand account.
- C. Determine the dividend refund for the year ending December 31, 2016.
- D. Determine B & C Limited's minimum federal Tax Payable for the year ending December 31, 2016. This should include both Part I and Part IV Tax Payable, net of any dividend refund. As the corporation operates in a province that has a reduced tax rate for M&P activity, a separate calculation of the federal M&P deduction is required.
- E. Determine the December 31, 2016 balance in B & C's GRIP.

## **Chapter Fourteen Test Item File Problems**

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### **TIF PROBLEM FOURTEEN - 1**

#### **Other Issues In Corporate Taxation - Essay Questions**

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1. Why does the government believe that it is necessary to have rules related to the acquisition of control of a corporation that has accumulated losses.
2. How is an acquisition of control defined? Describe a common event that would result in an acquisition of control.
3. ITA 249(4) requires that, when there is an acquisition of control, the acquired corporation will have deemed year end on the day preceding the acquisition of control. What is the objective of this requirement?
4. Briefly describe the basic tax consequences that result from an acquisition of control.
5. When control of a corporation is acquired, ITA 111(4)(e) permits the acquired corporation to elect to have a deemed disposition of any of its capital properties on which there is either unrealized recapture of CCA or unrealized capital gains. Under what circumstances would you advise a client to make this election? Briefly explain your conclusion.
6. Why is it necessary to have the associated company rules?
7. What characteristics define "shares of a specified class" under the provisions governing associated companies? What is a common designation for such shares?
8. How is "group" defined by the associated corporations legislation?
9. For purposes of applying the associated company rules, how is control defined?
10. For purposes of applying the associated company rules, there is a deeming rule with respect to the holding of rights. Briefly describe this rule.
11. If the government wanted to provide additional tax benefits, how would they choose between using a general rate reduction and, alternatively, one or more investment tax credits?
12. In general, investment tax credits require a taxpayer to exchange a given amount of tax deductions for the same amount of tax credits. Explain why this is favourable to the taxpayer.
13. Indicate the types of taxpayers that are eligible for refundable investment tax credits.
14. When a business receives an investment tax credit as the result of the acquisition of a depreciable asset, how does this affect the amount of CCA taken in the current and subsequent years?
15. The per share value for Paid Up Capital (PUC) will often be different than the per share value for Adjusted Cost Base (ACB). Briefly explain how such differences arise.
16. What is the basic purpose of the capital dividend account?
17. What is a stock dividend? What are the tax consequences for an individual receiving such dividends, as well as for the corporation issuing the dividend?
18. Corporations sometimes issue new shares in order to retire existing debt. In some cases,

the value of the shares issued will exceed the value of the debt retired. Describe the tax consequences that result from such a transaction.

19. When there is a winding up of a Canadian corporation, the shareholders will receive some amount of proceeds from the disposition of their shares. What are the tax consequences of receiving these proceeds?
20. A redemption of shares may result in an ITA 84(3) deemed dividend. As the redemption is also a disposition, there may also be a capital gain. Explain how tax legislation avoids some part of the proceeds received for the shares from being double counted as both a deemed dividend and a capital gain.

## **TIF PROBLEM FOURTEEN - 2**

### **Other Issues In Corporate Taxation - True Or False**

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#### **New For 2016/2017**

1. When there is an acquisition of control, any non-depreciable asset with an adjusted cost base in excess of its fair market value must be written down to its fair market value.  
True or False?
2. When a deemed year end is required as the result of an acquisition of control, this event will always be followed by a short fiscal period.  
True or False?
3. If a corporation elects to have a deemed disposition of a non-depreciable property whose fair market value is greater than its adjusted cost base prior to an acquisition of control, the elected value can be any value between the adjusted cost base and the fair market value of the property.  
True or False?
4. For purposes of determining associated companies, a group is any two or more related persons who hold shares in a corporation.  
True or False?
5. For purposes of determining associated companies, a parent is deemed to own any of a corporation's shares that are held by any of his children who are under the age of 18.  
True or False?
6. When a business receives an investment tax credit as a result of making a capital expenditure, the amount of the credit must be deducted from the UCC of the capital expenditures class in the taxation year in which the credit is received.  
True or False?
7. Non-refundable investment tax credits that are not used during the current year can be carried back 3 years and forward for 20 years.  
True or False?
8. An individual investor's PUC per share will generally be changed if the corporation issues additional shares, despite the fact that his adjusted base per share will not be changed.  
True or False?
9. Because no assets are distributed, stock dividends do not increase shareholders' Net Income For Tax Purposes.  
True or False?
10. While dividends in kind are treated as a taxable dividend to the recipient shareholders, they have no tax consequences for the corporation declaring the dividend.  
True or False?

### **Retained From Previous Editions**

11. Any net capital losses that remain unused after an acquisition of control cannot be used in years subsequent to the acquisition of control.

True or False?

12. If a corporation acquires goodwill for \$200,000, deducts maximum CEC for three years, and then sells the goodwill for \$250,000, there will be an addition to the capital dividend account of \$37,500.

True or False?

13. When a corporation redeems all or part of its outstanding shares, the difference between the proceeds of redemption and the PUC of the shares will be treated as a capital gain for tax purposes.

True or False?

14. Capital dividends that have been declared using the ITA 83(2) election are not subject to the usual gross up and tax credit procedures.

True or False?

## TIF PROBLEM FOURTEEN - 3

### Other Issues In Corporate Taxation - Multiple Choice

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#### New For 2016/2017

##### **Acquisition Of Control**

1. Which of the following items would not be lost when there is an acquisition of control?
  - A. Unused charitable donations.
  - B. Farm losses.
  - C. Allowable business investment losses.
  - D. Net capital losses.

##### **Associated Companies**

2. John Dough owns 100 percent of the shares of Doughboy Ltd. His wife, Kneada Dough, owns 100 percent of the shares of Yeast Ltd. and 100 percent of the shares of Flour Inc. Which of the following statements is correct?
  - A. Doughboy and Yeast are associated.
  - B. Flour and Yeast are associated.
  - C. Doughboy and Flour are associated.
  - D. Doughboy is associated with both Yeast and Flour.

##### **Investment Tax Credits**

3. Low Tech Inc. is a CCPC with 2016 SR&ED expenditures of \$685,000. The Company has no Taxable Income in 2016 or any of the three preceding years. In 2015, the Company's Taxable Capital Employed In Canada was \$7 million. Determine their total investment tax credit for the year and indicate the amount that would be refundable.
  - A. The total credit would be \$239,750. The refundable amount would be \$239,750.
  - B. The total credit would be \$239,750. The refundable amount would be \$102,750.
  - C. The total credit would be \$102,750. The refundable amount would be \$102,750.
  - D. The total credit would be \$102,750. The refundable amount would be \$41,100.

##### **Tax Basis Shareholders' Equity**

4. Tardex Inc. has only one class of shares. At the end of 2016, the company had 30,000 shares outstanding. The shares had been sold in 3 blocks of 10,000 each. The first block was sold at \$8 per share, the second at \$9 per share, and the third at \$11 per share. Mark Forest acquired 200 shares of the first offering and an additional 300 shares of the second offering. The total PUC of Mark's shares is equal to:
  - A. \$4,300
  - B. \$4,665
  - C. \$4,250
  - D. \$5,500

##### **Stock Dividends**

5. Which of the following statements with respect to stock dividends is correct?
  - A. Stock dividends are not subject to the usual gross up and tax credit procedures.
  - B. A stock dividend can never be designated as an eligible dividend.
  - C. A dividend will be taxable to the extent that the corporation has increased its PUC in the process of declaring the dividend.
  - D. When an investor receives a stock dividend, it does not affect the adjusted cost base of his shareholding.

**Dividends In Kind**

6. With respect to dividends in kind, which of the following statements is correct?
- A. A dividend in kind is not subject to the usual gross up and tax credit procedures.
  - B. A dividend in kind will not affect the income of the declaring corporation.
  - C. A dividend in kind can result in a capital gain for the declaring corporation.
  - D. A dividend in kind can never be designated as an eligible dividend.

**Distributions Of Corporate Surplus**

7. Scranton Inc. is a CCPC with a nil GRIP balance. It has 100,000 shares outstanding, all of which were issued at a price of \$8.00 per share. Nellie Ward owns 10,000 of these shares which she acquired at a cost of \$7.00 per share. During 2016, the company redeems Nellie's shares at a price of \$10.00 per share. Which of the following amounts will be included in Nellie's Net Income For Tax Purposes as a result of the redemption?
- A. \$25,000.
  - B. \$33,400.
  - C. \$30,000.
  - D. \$28,400.

**Retained From Previous Editions****Acquisition Of Control**

8. Which of the following is **NOT** a consequence of an acquisition of control?
- A. A deemed year end.
  - B. The inability to deduct existing non-capital losses subsequent to the acquisition of control.
  - C. The inability to deduct existing net capital losses subsequent to the acquisition of control.
  - D. A requirement to write down non-depreciable assets to their fair market value.
9. Rushmore Limited, a distributor of leather raw materials, currently owns 15 percent of the outstanding common shares of Mount Limited. Bush Limited and Trailco respectively own 52 percent and 33 percent of the outstanding common shares of Mount Limited. Mount Limited, a large shoe manufacturer, has had several years of large losses.
- Which one of the following percentages represents the **minimum** percentage of additional common shares of Mount Limited that Rushmore Limited must purchase in order that there be an acquisition of control?
- A. 33%.
  - B. 36%.
  - C. 50%.
  - D. 51%.
10. Which of the following statements with respect to acquisition of control procedures is **NOT** correct?
- A. Prior to the deemed year end, non-depreciable assets will have to be written down to their fair market value.
  - B. Net capital losses cannot be carried back to a year prior to the acquisition of control.
  - C. Subsequent to the deemed year end, non-capital losses can be deducted against any type of income.
  - D. Prior to the deemed year end, the acquired company can elect to have a deemed disposition of any of their capital assets.

*Other Issues In Corporate Taxation - Multiple Choice*

11. Which of the following is **NOT** an implication of a deemed year end which creates a short fiscal period?
- A. The corporate tax rate must be prorated for the shortened year.
  - B. CCA calculations must be based on a fraction of a year.
  - C. The annual business limit must be prorated.
  - D. The period during which time-limited losses can be used is shortened.
12. Which of the following is **NOT** a restriction that applies to the use of non-capital losses after an acquisition of control?
- A. The corporation must continue to carry on the business in which the loss occurred.
  - B. There must be a reasonable expectation of profit in that business.
  - C. The losses cannot be applied in any shortened year ends that occur as a result of the acquisition of control.
  - D. The losses can only be applied against future income generated by the same or a similar business.
13. VanDeKamp Holdings operates two separate lines of business – a catering business and a cookbook publishing business. During the year ended December 31, 2016, the company lost \$300,000 from the catering business and earned a profit of \$100,000 from the cookbook publishing business. The \$200,000 non-capital loss could not be carried back, and as a result it was carried forward. On January 1, 2017, VanDeKamp Holdings is acquired by another company. During the 2017 year, the catering business lost another \$150,000 while the cookbook publishing business earned \$350,000. What portion of the loss carry forward can be deducted in the 2017 fiscal year?
- A. None.
  - B. \$100,000.
  - C. \$150,000.
  - D. \$200,000.
14. Solis Enterprises Inc. operates two separate lines of business – a fashion design business and an investment firm. During the year ended December 31, 2016, the company lost \$3 million from the fashion design business and earned a profit of \$1 million from the investment firm. The \$2 million non-capital loss could not be carried back, and as a result it was carried forward. On January 1, 2017, Solis Enterprises Inc. is acquired by another company. During the 2017 year, the fashion design business lost another \$1.5 million while the investment firm earned \$4 million. What is the minimum taxable income for 2017?
- A. \$0
  - B. \$500,000
  - C. \$2,500,000
  - D. \$4,000,000

15. Hagrid Inc. is subject to an acquisition of control on January 1, 2017. The company has an operating loss of \$65,000 in the year prior to the acquisition of control, which cannot be carried back. On December 31, 2016, the company had two assets, a piece of land with an ACB of \$150,000 and fair market value of \$65,000; and a depreciable asset with a capital cost of \$100,000, a UCC of \$75,000 and a fair market value of \$200,000. What write downs and elections are available to Hagrid Inc. in order to minimize the amount of losses carried forward to the 2017 year?
- A. Hagrid Inc. should elect to recognize the allowable capital loss of \$42,500 on the land at the end of 2016. A gain on the depreciable asset must be recorded, and this would be comprised of recapture of \$25,000 and a taxable capital gain of \$50,000.
  - B. Hagrid Inc. will be required to write the land down to its fair market value and recognize the allowable capital loss of \$42,500 at the end of 2016. A deemed disposition of the depreciable asset should be elected at a value of \$185,000, resulting in recapture of \$25,000 and a taxable capital gain of \$42,500.
  - C. Hagrid Inc. will be required to write the land down to its fair market value and recognize the allowable capital loss of \$42,500 at the end of 2016. No elections are available to the company.
  - D. Hagrid Inc. should elect to recognize the allowable capital loss of \$42,500 on the land at the end of 2016. A deemed disposition of the depreciable asset should be elected at a value of \$100,000, resulting in recapture of \$25,000.
16. When there is an acquisition of control of a corporation, which of the following is correct?
- A. A capital loss arising prior to the acquisition of control may be applied against capital gains realized by the business that incurred the capital loss on assets that were held prior to the acquisition of control.
  - B. Any capital losses that arise subsequent to the acquisition of control will be lost.
  - C. Non-capital losses arising prior to the acquisition of control may be applied against income earned by the business that incurred the loss as long as the loss has not expired.
  - D. Non-capital losses and capital losses arising prior to the acquisition of control will be lost.

**Associated Companies**

17. Mr. Hanes owns 100 percent of the common shares of Jimbo Corp. and 40 percent of the common shares of Hughes Corp. Hughes Corp. owns 80 percent of the common shares of ARC Ltd. Mr. Hanes' daughter-in-law also owns 5 percent of the common shares of Hughes Corp., and 15 percent of the common shares of ARC Ltd. The remaining shares are held by parties who deal at arm's length with Mr. Hanes and his daughter-in-law. The following Companies are associated under ITA 256 of the *Income Tax Act*:
- A. Only Jimbo and Hughes are associated.
  - B. Only Jimbo and ARC are associated
  - C. Hughes and ARC are associated, and Jimbo and ARC are associated.
  - D. Only Hughes and ARC are associated
  - E. None of Jimbo Corp., Hughes Corp., and ARC Ltd. are associated.

18. In which of the following situations are A Ltd. and B Ltd. associated?
- Mrs. Jax owns 60 percent of A Ltd. and Mrs. Jax's niece owns 80 percent of B Ltd. Mrs. Jax's husband owns the other 40 percent of A Ltd. and 20 percent of B Ltd.
  - Mr. B. owns 60 percent of A Ltd. and 20 percent of B Ltd. Mrs. B, Mr. B's spouse, owns the remaining 40 percent of A Ltd. The remaining 80 percent of B Ltd. is owned equally by Mr. and Mrs. D, who are not related to Mr. and Mrs. B.
  - Amos Dans owns 35 percent of each of A Ltd. and B Ltd. Amos Dan's brother owns an additional 20 percent of A Ltd. and 30 percent of B Ltd. The remaining 45 percent of A Ltd. and 35 percent of B Ltd. are owned by XYZ Ltd. and JBC Ltd., respectively. XYZ Ltd. and JBC Ltd. are not associated companies.
  - Young Ltd. owns 55 percent of B Ltd. and 40 percent of A Ltd. Boyle Holdings Ltd. owns the remaining 45 percent of B Ltd., and Kula Holdings Ltd. owns the remaining 60 percent of A Ltd. Kula Holdings Ltd. and Boyle Holdings Ltd. are owned by L. Kula and A. Boyle, respectively, who are not related.
19. Simon Williams owns 100 percent of Wonder Technologies Inc. Peter Maximoff owns 100 percent of Speedy Delivery Service Ltd. Simon and Peter each own 50 percent of Scarlet Decorating Ltd. Simon is married to Peter's sister, Wanda.
- Assuming each of the three corporations is a CCPC and has at least \$500,000 of active business income earned in Canada, what is the maximum combined corporate income on which the three corporations can claim the small business deduction?
- Nil.
  - \$ 500,000.
  - \$1,000,000.
  - \$1,500,000.
20. Which of the following situations does **NOT** describe two associated corporations?
- K Corp. owns 51 percent of the shares of L Corp. The remainder of the shares are owned by a party unrelated to K Corp.
  - Mr. and Mrs. G each own 50 percent of the shares of W Corp. Their adult children, Girl F and Boy F, each own 40 percent of V Corp. Mrs. G owns the remaining 20 percent of the V Corp. shares.
  - D Corp. is wholly owned by Mrs. X. Mr. X, the husband of Mrs. X, owns 65 percent of the shares of E Corp. Mrs. X owns the remaining 35 percent of the E Corp shares.
  - Boy M, an adult, owns 100 percent of the shares of Z Corp. Boy M, his mother and his father each own 30 percent of the shares of Y Corp. The remaining shares of Y Corp. are owned by Boy M's girlfriend.

### **Investment Tax Credits**

21. Miracle Works Inc. is located in Newfoundland. The company hires 3 eligible apprentices, paying each of them \$30,000 in the current year. It also acquires \$2,000,000 in qualified depreciable property. What are the tax consequences of these transactions for the current year?
- The company will receive investment tax credits of \$206,000. CCA for the current year will be based on the addition of \$2,000,000 to the CCA class of the qualified property.
  - The company will receive investment tax credits of \$6,000. CCA for the current year will be based on the addition of \$2,000,000 to the CCA class of the qualified property.
  - The company will receive investment tax credits of \$206,000. CCA for the current year will be based on the addition of \$1,800,000 to the CCA class of the qualified property.
  - The company will receive investment tax credits of \$209,000. CCA for the current year will be based on the addition of \$2,000,000 to the CCA class of the qualified property.

*Other Issues In Corporate Taxation - Multiple Choice*

22. Mira Glow Ltd. is a CCPC throughout the 2016 taxation year. During the 2015 taxation year, the company had taxable income of \$467,000. Also for 2015, the company had Taxable Capital Employed in Canada of \$14,000,000, while it was \$15,000,000 for 2016. What is the annual SR&ED expenditure limit for Mira Glow Ltd. for 2016?
- A. \$ 2,625,000
  - B. \$ 2,700,000
  - C. \$ 2,997,000
  - D. \$ 3,000,000

**Tax Basis Shareholders' Equity**

23. Torin Inc. has 500,000 shares issued and outstanding. These shares were issued for total consideration of \$1,125,000. At a later point in time, Jane Dow acquired 1,000 of these shares at a total cost of \$3,500. With respect to Ms. Dow's holding of Torin shares, which of the following statements is **NOT** correct?
- A. The PUC of Ms. Dow's shares is \$2,250.
  - B. The adjusted cost base of Ms. Dow's shares is \$3,500.
  - C. If she were to sell the Torin shares for \$4,000, she would have a taxable capital gain of \$250.
  - D. If she were to sell the Torin shares for \$4,000, she would have a deemed dividend of \$500.
24. Which of the following items would **NOT** be added to the capital dividend account of a private company?
- A. Life insurance proceeds received.
  - B. Dividends received from other taxable Canadian corporations.
  - C. Capital dividends received from other corporations.
  - D. The non-taxable portion of capital gains.
25. Gains Inc. had a balance in its capital dividend account of \$150,000 at January 1, 2016. During the 2016 year, the company had a taxable capital gain of \$50,000, allowable capital losses of \$30,000, received a capital dividend of \$35,000 from a subsidiary, and paid eligible dividends of \$45,000. On November 15, 2016, a capital dividend of \$32,000 was paid, and the appropriate election was filed. What is the balance in the capital dividend account at December 31, 2016?
- A. \$128,000
  - B. \$138,000
  - C. \$173,000
  - D. \$203,000
26. Which of the following is **NOT** a component of retained earnings for a CCPC from a tax perspective?
- A. Post-1971 Undistributed Surplus
  - B. Pre-1972 Capital Surplus On Hand
  - C. Capital Dividend Account
  - D. LRIP
27. Which of the following statements about tax based shareholders' equity is **NOT** correct?
- A. Paid up capital is the tax equivalent of contributed capital under GAAP.
  - B. The capital dividend account has no equivalent balance under GAAP.
  - C. The per share value of PUC is the same for all shareholders of a specified class.
  - D. While the components may be different, retained earnings will have the same value in both tax based shareholders' equity and in GAAP based financial statements.

**Stock Dividends**

28. Vadel Inc., a Canadian public company, has 1,000,000 shares outstanding with a total PUC of \$1,750,000. Mr. Vincent Dorval owns 5,000 of these shares with an adjusted cost base of \$11,250. Vadel Inc. declares a 5 percent non-eligible stock dividend at a time when its shares are trading at \$2.50 per share. Which of the following statements is correct?
- A. Mr. Dorval's Taxable Income will increase by \$731.25 as a result of the dividend.
  - B. After the dividend, the adjusted cost base of Mr. Dorval's shares will be \$11,875.
  - C. After the dividend, the PUC of Vadel's shares will be \$1,875,000.
  - D. All of the above.
  - E. None of the above.

**Dividends In Kind**

29. Mark is the only shareholder of Sico Ltd., a Canadian controlled private corporation. The CCPC has no balance in its GRIP account. In 2016, Sico paid a dividend in kind by distributing securities with fair market value of \$72,000 and an adjusted cost base of \$56,000. Which of the following statements properly reflects the tax consequences of this transaction?
- A. Sico has Taxable Income of \$8,000 and Mark has Taxable Income of \$72,000.
  - B. Sico has Taxable Income of \$8,000 and Mark has Taxable Income of \$84,240.
  - C. Sico has Taxable Income of nil and Mark has Taxable Income of \$72,000.
  - D. Sico has Taxable Income of \$16,000 and Mark has Taxable Income of \$84,240.

**Distributions Of Corporate Surplus**

30. Which of the following transactions will **NOT** result in a deemed dividend?
- A. Paying off \$500,000 in debt by issuing shares with a fair market value of \$525,000.
  - B. Redeeming shares for \$350,000. The PUC of the shares was \$350,000 and the adjusted cost base was \$250,000.
  - C. A liquidating dividend is paid to shareholders in the amount of \$400,000. At this time, PUC is reduced by \$300,000.
  - D. A total of \$1,000,000 was paid to shareholders as part of a winding-up. The PUC of the shares was \$200,000 and there was no capital dividend account balance.
31. Aris Ltd. has 2,000,000 shares outstanding with a total PUC of \$30,000,000. The Company is a CCPC and has no balance in its GRIP account. John Aris owns 10 percent of these shares. They were acquired at a total cost of \$2,250,000. During the current year, John's shares were redeemed by the corporation for proceeds of \$3,500,000. Which of the following amounts must be included in John's income as a result of this redemption?
- A. \$1,250,000
  - B. \$ 875,000
  - C. \$1,335,000
  - D. \$ 960,000
32. Which of the following transactions that involve an increase in PUC will result in an ITA 84(1) deemed dividend?
- A. A stock dividend is declared that increases PUC in excess of the increase in net assets.
  - B. The PUC of one class of shares is increased, and the PUC of another class is decreased an equivalent amount.
  - C. A corporation issues shares to a creditor in order to settle debt with a carrying value less than the PUC of the newly issued shares.
  - D. When consideration received for shares issued is in excess of the amount added to PUC.

33. What are the tax consequences associated with a corporation issuing shares to a creditor in order to retire a debt that has a carrying value lower than the PUC of the shares issued?
- A. There will be a reduction in PUC and ACB for all the shares that were outstanding prior to the debt retirement transaction.
  - B. There will be a deemed dividend which will be allocated to all shareholders including the new shareholder who acquired shares by giving up debt securities. The adjusted cost base of the shares will increase by the amount of the deemed dividend.
  - C. There will be a deemed dividend allocated to the new shareholder who acquired shares by giving up debt securities. The adjusted cost base of the shares will increase by the amount of the deemed dividend.
  - D. There will be a deemed dividend allocated to all shareholders including the new shareholder who acquired shares by giving up debt securities. The adjusted cost base of the shares will not be affected.
34. At the beginning of the current year, Brou Inc. sells all of its assets and pays its liabilities. Afterwards, the company has \$350,000 in cash which is distributed to the sole shareholder, Mr. Daniel. Mr. Daniel purchased the shares from the former shareholder for \$50,000. The PUC of the shares is \$10,000. The balance in the capital dividend account is \$65,000, and the company makes all appropriate elections with respect to this balance. What is the amount of the deemed dividend to Mr. Daniel?
- A. \$ 65,000.
  - B. \$ 275,000.
  - C. \$ 300,000.
  - D. \$ 340,000.
35. At the beginning of the current year, Shahbaz Inc., a CCPC, has shares with a PUC of \$4,000,000, and a balance of \$300,000 in its capital dividend account. The company was started by Mr. Sheikh, who made a \$4,000,000 investment in the common shares. During the current year, the company has disposed of a major division, and it will distribute \$1,000,000 to its sole shareholder, Mr. Sheikh. The company will reduce the PUC by \$600,000 in order to minimize the tax consequences to Mr. Sheikh. What is the ACB of Mr. Sheikh's shares after this transaction is completed?
- A. \$3,000,000.
  - B. \$3,400,000.
  - C. \$3,600,000.
  - D. \$4,000,000.
36. SSS Corp agrees to accept common shares with a PUC of \$100,000 from TTT Ltd. in exchange for the retirement of debt with a carrying value of \$90,000. What are the tax consequences of this exchange?
- A. The shareholders of TTT Ltd. will be deemed to have received a dividend of \$10,000.
  - B. The shareholders of SSS Corp will be deemed to have received a dividend of \$10,000.
  - C. SSS Corp will have realized a capital gain of \$10,000.
  - D. There will be no immediate tax consequences.

## **TIF PROBLEM FOURTEEN - 4**

### **Other Issues In Corporate Taxation - Exam Exercises**

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***Exam Exercise Subject Listing For Chapter 14***

<b>Number</b>	<b>Subject</b>
1	Acquisition Of Control
2	Acquisition Of Control
3	Election On Acquisition Of Control
4	Election On Acquisition Of Control
5	Associated Companies
6	Associated Companies
7	Investment Tax Credit Procedure
8	Investment Tax Credit Procedure
9	Refundable Investment Tax Credits
10	Refundable Investment Tax Credits
11	ACB And PUC
12	ACB And PUC
13	Capital Dividend Account
14	Capital Dividend Account
15	Stock Dividends
16	Stock Dividends
17	Dividends In Kind
18	Dividends In Kind
19	ITA 84(1) Deemed Dividend
20	ITA 84(1) Deemed Dividend
21	ITA 84(2) Deemed Dividend
22	ITA 84(2) Deemed Dividend
23	ITA 84(3) Deemed Dividend
24	ITA 84(3) Deemed Dividend
25	ITA 84(4) Deemed Dividend
26	ITA 84(4) Deemed Dividend

**Exam Exercise Fourteen - 1 (Acquisition Of Control)**

Lead Services Ltd. operates two separate lines of business, one of which sells drafting pencils, the other provides professional engineering services. In its first year of operations ending December 31, 2015, the engineering services business had a loss of \$104,000, and the pencil business had income of \$24,600, resulting in a Net Income For Tax Purposes of nil.

For the taxation year ending December 31, 2016, the engineering services business had income of \$21,250 and the pencil business had income of \$133,400, resulting in a Net Income For Tax Purposes of \$154,650. The Company has no deductions from Net Income For Tax Purposes other than possible loss carry forwards from 2015. Determine the minimum Taxable Income for each of the two years, and any loss carry forward available at the end of the year assuming that there was no acquisition of control in either year. How would your answer be different if there was an acquisition of control on January 1, 2016?

**Exam Exercise Fourteen - 2 (Acquisition Of Control)**

Ambee Ltd. commenced operations in 2015, and has two separate lines of business. They are a mail order operation selling organic food products, and an operation that provides accounting services to small business. The income (loss) of the two operations for the years 2015 and 2016 are as follows:

Year	Mail Order Operation	Accounting Operation
2015	(\$146,000)	\$ 43,000
2016	56,000	85,000

The Company has no deductions from Net Income For Tax Purposes other than possible loss carry forwards from 2015.

Determine the minimum Taxable Income for each of the two years, and any loss carry forward available at the end of the year assuming that there was no acquisition of control in either year. How would your answer be different if there was an acquisition of control on January 1, 2016?

**Exam Exercise Fourteen - 3 (Election On Acquisition Of Control)**

Static Controls Inc. has a December 31 year end. On May 1, 2016, all of the Company's shares are acquired by a new owner. For the period January 1, 2016 through April 30, 2016, the Company has an operating loss of \$91,000.

On April 30, 2016, the Company has available a net capital loss carry forward of \$125,000 [(1/2)(\$250,000)]. In addition, the Company has the following assets:

Asset Type	Adjusted Cost Base Or Capital Cost	UCC	Fair Market Value
Non-Depreciable	\$610,000	N/A	\$740,000
Depreciable	375,000	\$280,000	515,000

Advise the Company with respect to the most appropriate elections to be made prior to the acquisition of control and explain your results.

**Exam Exercise Fourteen - 4 (Election On Acquisition Of Control)**

During its taxation year ending December 31, 2016, all of the shares of Vick Ltd. are acquired by a new owner. The acquisition occurs on May 1, 2016 and, at that time, Vick has available a net capital loss of \$175,000 [(1/2)(\$350,000)]. Also at that time the company has the following assets:

Asset Type	Adjusted Cost Base Or Capital Cost	UCC	Fair Market Value
Non-Depreciable	\$754,000	N/A	\$950,000
Depreciable	490,000	\$325,000	612,000

For the period January 1, 2016 through April 30, 2016, the company has an operating loss of \$143,000.

Advise the Company with respect to the most appropriate elections to be made prior to the acquisition of control and explain your results.

**Exam Exercise Fourteen - 5 (Associated Companies)**

Anderson Inc., BDO Ltd., and Copper Inc., are three Canadian controlled private corporations. The common share ownership is as follows:

**Anderson Inc.** John Anderson owns 100 percent of the common shares of this Company.

**BDO Ltd.** John Anderson owns 30 percent of the common shares and his spouse, Wilma Anderson, owns 10 percent of the common shares. Basil Copper owns 35 percent of the common shares and his spouse, Holly Copper, owns 25 percent of the common shares. Holly Copper is John Anderson's sister.

**Copper Inc.** Basil Copper and Holly Copper each own 50 percent of the common shares of this Company.

Indicate which of the Companies described are associated. Explain your conclusions.

**Exam Exercise Fourteen - 6 (Associated Companies)**

Sarah Kern owns 80 percent of the shares of Kern Ltd. and 5 percent of the shares of Lorne Inc. Kern Ltd. owns 30 percent of the shares of Lorne Inc. Sarah's 12 year old daughter owns 25 percent of the shares of Lorne Inc. There are no other shareholders who hold shares in both Companies. Are Kern Ltd. and Lorne Inc. associated? Explain your conclusion.

**Exam Exercise Fourteen - 7 (Investment Tax Credit Procedures)**

During the taxation year ending December 31, 2016, Dwanto Ltd. makes current expenditures of \$460,000 on which a 10 percent investment tax credit is available. In addition, it acquires \$675,000 of Class 10 assets on which a 10 percent investment tax credit is available. Describe the 2016 and 2017 tax consequences associated with making these expenditures and claiming the related investment tax credits. Include in your solution the CCA for 2016 and 2017.

**Exam Exercise Fourteen - 8 (Investment Tax Credit Procedures)**

During the taxation year ending December 31, 2016, Enco Ltd. makes current expenditures of \$722,000 on which a 10 percent investment tax credit is available. They also acquire \$942,000 in Class 8 assets on which a 10 percent investment tax credit is available. Describe the 2016 and 2017 tax consequences associated with making these expenditures and claiming the related investment tax credits. Include in your solution the CCA for 2016 and 2017.

**Exam Exercise Fourteen - 9 (Refundable Investment Tax Credits)**

During the taxation year ending December 31, 2016, Future Ventures has made a number of expenditures that qualify for investment tax credits. They are as follows:

- \$132,000 in Qualified Property in the Gaspé Peninsula.
- \$1,060,000 in current expenditures for Scientific Research And Experimental Development.

The Company is a Canadian controlled private corporation. For 2015, Future Ventures has Taxable Income of \$161,000 and Taxable Capital Employed In Canada of \$8,500,000. The Company has no Tax Payable for 2016 or in any of the three preceding years.

Determine the amount of the refund that Future Ventures will receive as a result of earning these investment tax credits and any available carry forwards. Include in your answer any other tax consequences of these investment tax credits.

**Exam Exercise Fourteen - 10 (Refundable Investment Tax Credits)**

During the taxation year ending December 31, 2016, Forward Ltd. makes the following expenditures that qualify for investment tax credits:

- \$1,450,000 in current expenditures for Scientific Research And Experimental Development.
- \$220,000 in expenditures for Qualified Property in the Atlantic Provinces.

The Company is a CCPC with Taxable Income in 2015 of \$417,000. Also for 2015, its Taxable Capital Employed in Canada was \$6,200,000. The Company has no Tax Payable for 2016 or in any of the three preceding taxation years.

Determine the amount of the refund that Forward Ltd. will receive as a result of earning these investment tax credits and any available carry forwards. Include in your answer any other tax consequences of these investment tax credits.

**Exam Exercise Fourteen - 11 (ACB And PUC)**

When it was first established, Lichter Inc. issued 123,000 shares at a price of \$5.60 per share. Four years later, an additional 32,000 shares were issued for \$8.62 per share. During the current year, a further 81,000 shares were issued for \$10.15 per share. One of the investors in the Company acquired 1,350 shares of the first group of shares issued, and an additional 4,230 shares from the most recent issue. Determine the adjusted cost base per share, as well as the total PUC of this investor's shares.

**Exam Exercise Fourteen - 12 (ACB And PUC)**

Martex Inc. has 560,000 shares outstanding. Information on their issuance is as follows:

Date	Shares Issued	Issue Price	Total Proceeds
January, 2015	400,000	\$16.00	\$6,400,000
June, 2016	160,000	18.00	2,880,000
Totals	560,000		\$9,280,000

Joan Fox acquired 10,000 shares of the 2015 issue and 5,000 shares of the 2016 issue. Determine the adjusted cost base per share, as well as the total PUC of Joan's shares.

**Exam Exercise Fourteen - 13 (Capital Dividend Account)**

The following transactions involve the Logic Corporation's capital dividend account:

- In 2005, they sold a capital asset with an adjusted cost base of \$105,000 for cash of \$129,000.
- In 2006, they sold a non-depreciable capital asset with an adjusted cost base of \$91,000 for cash of \$83,000.
- During the year ending December 31, 2015, the Company received a capital dividend of \$10,600.
- On July 1, 2016, they sold goodwill for proceeds of \$50,000. They had paid \$39,500 for this goodwill in the previous year. There have been no other additions to the cumulative eligible capital balance. It is the Company's policy to make maximum CCA and CEC deductions.
- On October 31, 2016, the Company paid an ITA 83(2) capital dividend of \$13,750. The appropriate election was made.

Determine the balance in the capital dividend account at December 31, 2016.

**Exam Exercise Fourteen - 14 (Capital Dividend Account)**

Export Ltd. is a Canadian private company with a December 31 year end. The transactions which follow involve Export Ltd.'s capital dividend account.

- During 2005, the Company received a capital dividend of \$23,000.
- During 2008, the Company sold a capital asset with an adjusted cost base of \$156,000 for cash proceeds of \$199,000.
- During 2010, the Company sold an unlimited life franchise for \$150,000. The Company had paid \$125,000 for it in 2008. There have been no other additions to the cumulative eligible capital balance. It is the Company's policy to make maximum CCA and CEC deductions.
- During 2011, the Company sold a non-depreciable capital asset with an adjusted cost base of \$120,000 for cash proceeds of \$102,000.
- During 2016, the Company paid an ITA 83(2) capital dividend of \$10,400.

Determine the balance in the capital dividend account at December 31, 2016.

**Exam Exercise Fourteen - 15 (Stock Dividends)**

On June 30, 2016, the Shareholders' Equity of Mondo Inc. is as follows:

Common Stock (56,000 Shares Outstanding)	\$ 672,000
Retained Earnings	726,000
<u>Total Shareholders' Equity</u>	<u>\$1,398,000</u>

On this date, the Company declares a 10 percent stock dividend. This dividend is not designated as eligible. At this time, the shares are trading at \$27 per share. The Company increases its PUC by the fair market value of the new shares issued.

Jerry Folder is holding 1,000 of the Mondo shares which he acquired several years ago at a cost of \$17 per share. Determine the effect of this transaction on Jerry's 2016 Net Income For Tax Purposes and 2016 federal Tax Payable. In addition, determine the adjusted cost base per share of his Mondo Inc. holding.

**Exam Exercise Fourteen - 16 (Stock Dividends)**

Jason Bright owns 500 shares of Latec Inc. These were purchased several years ago at \$15 per share, a total cost of \$7,500. On June 30, 2016, the Shareholder's Equity accounts of Latec were as follows:

Common Stock (100,000 Shares Outstanding)	\$1,200,000
Retained Earnings	1,800,000
<hr/>	
Total Shareholders' Equity	\$3,000,000
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On this date, Latec declares and pays a 5 percent non-eligible stock dividend. As the shares are trading at \$18 per share, the Company increases PUC by \$90,000 [(5%)(100,000)(\$18)].

Determine the effect of this transaction on Jason's 2016 Net Income For Tax Purposes and 2016 federal Tax Payable. In addition, determine the adjusted cost base per share of his Latec Inc. holding.

**Exam Exercise Fourteen - 17 (Dividends In Kind)**

Martine Cloutier owns 23 percent of the 400,000 outstanding shares of Boucher Inc. Boucher Inc. owns 45,000 shares of Montagne Inc. The Montagne Inc. shares were acquired at a cost of \$33 per share and have a current fair market value of \$42 per share. On June 30, 2016, Boucher Inc. declares a non-eligible dividend involving the distribution of all of the Montagne Inc. shares on a pro rata basis to its existing shareholders.

Determine the effect of the payment of this dividend on Boucher Inc.'s 2016 Net Income For Tax Purposes. In addition, determine the effect of the payment of this dividend on Martine Cloutier's 2016 Net Income For Tax Purposes and 2016 federal Tax Payable.

**Exam Exercise Fourteen - 18 (Dividends In Kind)**

Topex Ltd. owns 62,000 shares of Boron Ltd. While the shares were acquired at a total cost of \$372,000 (\$6.00 per share), the shares are currently trading at \$8.50 per share. Topex wishes to dispose of these shares and, to this end, they declare a non-eligible dividend on August 28, 2016, involving a distribution of Boron Ltd. shares on a pro rata basis to the Topex shareholders.

Determine the effect of paying this dividend on Topex's Net Income For Tax Purposes. In addition, determine the effect of receiving this dividend on an individual who holds 10 percent of the Topex Ltd. shares.

**Exam Exercise Fourteen - 19 [ITA 84(1) Deemed Dividend]**

At the beginning of the current year, Scott Inc. has 131,000 shares of common stock outstanding. The shares were originally issued at \$11.25 per share for total proceeds of \$1,473,750, with this amount constituting the PUC. During the current year, a creditor holding \$505,000 of the Company's debt agrees to accept 43,000 newly issued common shares of the Company in exchange for settlement of the debt obligation. At the time of this exchange, the shares are trading at \$12.05 per share. Subsequent to the exchange, Mr. Scott, who had purchased 7,000 Scott Inc. shares at the time of their original issue, sells the shares for \$14.36 per share.

Describe the tax consequence(s) to all of the shareholders of Scott Inc. as a result of the exchange of debt for common shares. In addition, describe the tax consequences to Mr. Scott resulting from the sale of his Scott Inc. shares.

**Exam Exercise Fourteen - 20 [ITA 84(1) Deemed Dividend]**

Zhao Inc. has 50,000 shares of common stock outstanding which were issued for total proceeds of \$450,000. On November 30, 2016, a creditor holding debt with a carrying value of \$100,000 agrees to take 10,000 newly issued common shares in order to settle the debt obligation. At the time of this exchange, the shares are trading for \$11.25 per share. Mr. Kai owns 1,000 shares in Zhao Inc, which he purchased on the market for \$10 on January 15, 2016. What is the amount of the deemed dividend to Mr. Kai?

**Exam Exercise Fourteen - 21 [ITA 84(2) Deemed Dividends]**

After selling its assets and paying all of its liabilities, a corporation has cash of \$1,237,000 available for distribution to its only shareholder. The corporation was established 12 years ago with an investment of \$189,000. This figure is both the PUC and the adjusted cost base of the shares. The balance in the capital dividend account is \$146,000 and the company makes the appropriate election to have the distribution of this amount be treated as a capital dividend under ITA 83(2). What are the tax consequences of distributing the \$1,237,000 to the corporation's only shareholder?

**Exam Exercise Fourteen - 22 [ITA 84(2) Deemed Dividends]**

Fortin Ltd. is winding up its operations. The Company has sold all of its assets and paid all of its liabilities, leaving a cash balance of \$956,000. Since beginning operations, the Company has had a single shareholder who invested \$120,000 to acquire all of its shares. The \$120,000 is both the PUC and the adjusted cost base of the shares. All of the cash balance will be distributed to this shareholder. As the Company has a \$45,000 balance in its capital dividend account, this amount will be treated as a ITA 83(2) capital dividend. What are the tax consequences of distributing the \$956,000 to the corporation's only shareholder?

**Exam Exercise Fourteen - 23 [ITA 84(3) Deemed Dividend]**

At the time of its incorporation, Alleham Ltd. issued 176,000 common shares in return for \$3,960,000 in cash (\$22.50 per share). All of the shares were issued to Mr. Izaak Alleham, the founder of the Company. Mr. Alleham is still holding all of the originally issued shares, except for 30,000 shares that Mr. Alleham sold to his sister for \$18.75 per share, the estimated fair market value of the shares at that time. Because Mr. Alleham does not approve of his sister's increasingly irresponsible lifestyle, he would prefer to sever all relations with her. To facilitate this goal, he arranges to have Alleham Ltd. redeem all of her 30,000 Alleham Ltd. shares at a price of \$24.35 per share. Any dividends resulting from the redemption will be non-eligible.

Determine the tax consequences of this redemption to Mr. Alleham, as well as to his sister.

**Exam Exercise Fourteen - 24 [ITA 84(3) Deemed Dividend]**

Elton Inc. has 220,000 common shares outstanding. All of these shares were issued at a price of \$12 per share, for total proceeds of \$2,640,000. This is the PUC of the shares.

A dissident shareholder, who acquired his 15,000 shares at a price of \$10 per share, has been a major problem for the Company. To rid itself of the problems associated with this individual, the Company has offered to redeem his shares at \$12.50 per share. This offer has been accepted. Any dividends resulting from the redemption will be non-eligible.

Determine the tax consequences of this redemption to the dissident shareholder.

***Exam Exercise Fourteen - 25 [ITA 84(4) Deemed Dividend]***

Ms. Daniels owns all of the outstanding shares of Daniels Inc., a CCPC. The shares have a PUC of \$390,000 and an adjusted cost base of \$545,000. Because it has recently consolidated its operations, Daniels Inc. pays a liquidating dividend of \$299,000, accompanied by a PUC reduction of \$217,000.

What are the tax consequences of this distribution to Ms. Daniels?

***Exam Exercise Fourteen - 26 [ITA 84(4) Deemed Dividend]***

Martin Forbes owns all of the outstanding shares of Carson Ltd., a CCPC. These shares have a PUC of \$225,000 and an adjusted cost base of \$310,000. Having sold a large segment of the operations, Carson Ltd. pays a liquidating dividend of \$112,000, accompanied by a PUC reduction of \$84,000.

What are the tax consequences of this distribution to Mr. Forbes?

**TIF PROBLEM FOURTEEN - 5A****Other Issues In Corporate Taxation - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 14, “Other Issues In Corporate Taxation”.

- A. Capital Dividend Account
- B. Contributed Capital
- C. Dividends In Kind
- D. Stock Dividend
- E. Liquidating Dividend
- F. Paid Up Capital
- G. Qualifying Corporation
- H. Redemption Of Shares

The following list contains ten potential definitions for the preceding key terms.

1. A balance that is, in general, equal to legal stated capital as determined under the legislation governing the particular corporation.
2. An account that tracks a group of items, defined in ITA 89(1), that can be distributed by private corporations to shareholders as a tax free capital dividend.
3. A group of capital transactions and distributions, as specified in ITA 84(1), that are deemed to be dividend payments.
4. A CCPC throughout the year with taxable income in the immediately preceding year of no more than \$500,000 and previous year taxable capital employed in Canada of \$10 million or less.
5. The residual interest of the shareholders of a corporation in the net assets of the corporation.
6. Dividends, other than stock dividends, paid in corporate assets other than cash.
7. A dividend that represents a return of invested capital.
8. A transaction in which a corporation purchases some of its own outstanding shares, either in the open market, or through a direct purchase from shareholders.
9. A pro rata distribution of corporation shares to existing shareholders of the corporation.
10. Any two or more persons, each of whom owns shares in the corporation.
11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM FOURTEEN - 5B****Other Issues In Corporate Taxation - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 14, "Other Issues In Corporate Taxation".

- A. Capital Dividend Account
- B. Contributed Capital
- C. Dividends In Kind
- D. Stock Dividend
- E. Liquidating Dividend
- F. Paid Up Capital
- G. Qualifying Corporation
- H. Redemption Of Shares

The following list contains 14 potential definitions for the preceding key terms.

1. A balance that is, in general, equal to legal stated capital as determined under the legislation governing the particular corporation.
2. An account that tracks a group of items, defined in ITA 89(1), that can be distributed by private corporations to shareholders as a tax free capital dividend.
3. A group of capital transactions and distributions, as specified in ITA 84(1), that are deemed to be dividend payments.
4. A transaction in which a shareholder redeems some or all of its shares in a CCPC.
5. A balance that is equal to Shareholders' Equity as determined under generally accepted accounting principles.
6. A dividend paid in stock that the paying company has held as a long-term investment.
7. A CCPC throughout the year with taxable income in the immediately preceding year of no more than \$500,000 and previous year taxable capital employed in Canada of \$10 million or less.
8. The residual interest of the shareholders of a corporation in the net assets of the corporation.
9. Dividends, other than stock dividends, paid in corporate assets other than cash.
10. A dividend that represents a return of invested capital.
11. A transaction in which a corporation purchases some of its own outstanding shares, either in the open market, or through a direct purchase from shareholders.
12. A pro rata distribution of corporation shares to existing shareholders of the corporation.

*Other Issues In Corporate Taxation - Key Term Matching (Moderate)*

13. An account that tracks a group of items, defined in ITA 89(1), that can be distributed by CCPCs to shareholders as a tax free capital dividend.
14. Any two or more persons, each of whom owns shares in the corporation.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM FOURTEEN - 6**

### **Acquisition Of Control - Losses**

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Fortunato Ltd. was incorporated 15 years ago in Alberta. All of the shares were issued to Mr. Salvatore Fortunato. The corporation operated a bakery and, for several years, it enjoyed satisfactory profits. The Company has a December 31 year end.

In 2012, Mr. Fortunato retired and turned the management of the business over to his daughter, Angela Fortunato. Mr. Fortunato retained ownership of all of the Company's shares.

Unfortunately, Angela demonstrated considerably more interest in fast cars and handsome men than she did in running the business. As a consequence, Fortunato Ltd. has experienced losses in every year since 2012. As of December 31, 2015, it has a non-capital loss carry forward of \$225,000, as well as a net capital loss carry forward of \$28,000 [(1/2)(\$56,000)].

On April 1, 2016, after a lengthy and heated discussion on the merits of various lifestyles, Mr. Fortunato fires his daughter and sells all of the shares in Fortunato Ltd. to Foodland Inc., a large public company involved in the production and distribution of a variety of food products.

For the period January 1, 2016 through March 31, 2016, Fortunato Ltd. experienced a business loss of \$26,000. This figure includes a write-down of inventories to their fair market values on March 31, 2016, and a deduction for uncollectible receivables, calculated as per the provisions of ITA 111(5.3). It does not include any taxable capital gains, allowable capital losses, Allowable Business Investment Losses, or property losses.

On March 31, 2016, Fortunato Ltd.'s assets had the following values:

<b>Asset</b>	<b>Cost</b>	<b>UCC</b>	<b>Fair Market Value</b>
Long-Term Investments*	\$ 32,000	N/A	\$ 90,000
Land	140,000	N/A	225,000
Building	426,000	\$320,000	426,000
Equipment	250,000	120,000	100,000

\*Foodland Inc. intends to sell these investments as soon as possible.

#### **Required:**

- A. Indicate the amount of any non-capital and net capital loss carry forwards that would remain after the April 1, 2016 acquisition of control, using the assumption that Foodland Inc. makes all elections required to minimize these amounts. Indicate the March 31, 2016 adjusted cost base and, where appropriate, UCC, for each of the assets listed.
- B. If Foodland Inc. decides to only use the election(s) required to eliminate those losses that would expire at the acquisition of control, indicate the assets on which the elections should be made, and the amounts that should be elected.
- C. Advise Foodland Inc. as to which course of action (Part A or B) they should take.

## **TIF PROBLEM FOURTEEN - 7**

### **Acquisition Of Control - Losses**

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Blackburn Inc. began operations in 2014. It was in the business of providing cleaning services to residential properties. All of the shares were owned by Aaron Blackburn and, in addition, he was actively involved in managing the business. The Company adopted a taxation year that ended on December 31.

Mr. Blackburn, whose previous career was as a professor of business strategy at a major Canadian university, showed little aptitude for actually running a business. In 2014, the business showed an operating loss of \$123,000. An additional operating loss of \$87,000 in 2015 brings the total non-capital loss carry forward balance to \$210,000 at December 31, 2015.

When the business commenced, Blackburn Inc. had acquired a parcel of land. Mr. Blackburn had intended to build there after the first location became successful. As success did not appear to be on the horizon, Blackburn Inc. sold this land in 2015. As a result of this disposition, Blackburn Inc. had a \$96,000 net capital loss on December 31, 2015.

In early 2016, Mr. Blackburn had to concede that his management skills were not adequate for the operation of Blackburn Inc. and he decided to return to his position as a business strategy professor. White Enterprises, a large public company agreed to buy all of his shares and, on May 1, 2016, the shares of Blackburn were transferred to that company.

As this acquisition of control resulted in a deemed year end, Blackburn Inc. prepared an Income Statement for the period January 1, 2016 through April 30, 2016. This short fiscal period statement showed an additional business loss of \$46,000 for this period. There were, however, no further capital losses.

On April 30, 2016, the values of the Company's assets were as follows:

<b>Asset</b>	<b>Cost</b>	<b>UCC</b>	<b>Fair Market Value</b>
Temporary Investments	\$ 45,000	N/A	\$ 12,000
Accounts Receivable	90,000	N/A	76,000
Land	180,000	N/A	262,000
Building	325,000	\$300,000	380,000
Equipment	93,000	60,000	45,000
Vehicles (Class 10)	145,000	110,000	132,000

Shortly after taking over Blackburn Inc., White Enterprises decided that some of the extra space in Blackburn's facilities could be used for manufacturing customized small kitchen appliances. Blackburn's income (loss) from the two separate businesses for the period May 1, through December 31, 2016 and the 2017 taxation year was as follows:

<b>Business</b>	<b>May 1 to Dec. 31, 2016</b>	<b>2017 Year</b>
Kitchen Appliances	\$146,000	(\$ 52,000)
Cleaning Services	( 23,000)	263,000

#### **Required:**

- A. If Blackburn 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 after the acquisition of control by White Enterprises, and the amount of the net capital loss carry forward that will be lost as a result of this change in ownership.
- B. Indicate the maximum amount of the non-capital loss carry forward that can be used during the period May 1 through December 31, 2016, and the amount remaining at December 31, 2016.
- C. Indicate the maximum amount of the non-capital loss carry forward that can be used during 2017, and the amount remaining at December 31, 2017.

## TIF PROBLEM FOURTEEN - 8

### Associated Companies

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Each of the following is an **independent** Case involving the ownership of voting shares of Canadian controlled private corporations. All of these corporations have taxation years that end on December 31 and have only one class of share.

1. Mr. Anson, a resident of Alberta, owns 80 percent of the shares of Anson Ltd. and 15 percent of the shares of Baron Inc. Mr. Baron, a resident of Quebec, owns 85 percent of the shares of Baron Inc. and 20 percent of the shares of Anson Ltd. Mr. Anson and Mr. Baron are not related.
2. Dunston Ltd. owns 70 percent of the shares of Edson Ltd. Edson Ltd. owns 80 percent of the shares of Farley Ltd.
3. Mr. Larry Grange owns 100 percent of the shares of LG Inc. His common-law partner, Mr. George Lawrence, owns 100 percent of the shares of GL Inc.
4. Ms. Patricia Hanson owns 80 percent of the shares of Hanson Inc. Her common-law partner Ms. Helen Porter owns 90 percent of the shares of Porter Inc. Ms. Hanson and Ms. Porter each own 30 percent of Liliti Ltd.
5. Mr. Bruce Korngold owns 80 percent of the shares of BK Ltd. and 15 percent of the shares of Lorey Ltd. BK Ltd. owns 30 percent of the shares of Lorey Ltd. Bruce's 10 year old son owns 20 percent of the shares of Lorey Ltd. There are no other shareholders who hold shares in both companies.

**Required:** For each of the preceding Cases, determine whether the corporations are associated. Support your conclusions with references to specific provisions of ITA 256. In order 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.

## TIF PROBLEM FOURTEEN - 9

### Associated Companies

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The following situations are **independent** of each other. All of the corporations involved are Canadian controlled private corporations and have only one class of shares.

- A. Mr. Johnson, Mr. Kohn, and Mr. Langley are three unrelated individuals.
- Mr. Johnson owns 50 percent of the shares of Astro Inc. and 25 percent of the shares of Borealis Ltd.
  - Mr. Kohn owns 50 percent of the shares of Borealis Ltd.
  - Mr. Langley owns 50 percent of the shares of Astro Inc. and 25 percent of the shares of Borealis Ltd.
- B. Ms. Martineau and Ms. Olson each own 50 percent of the shares of Kisler Inc. Ms. Martineau owns 70 percent of the shares of Pardo Ltd. Ms. Olson owns the remaining 30 percent of this Company's shares. Ms. Martineau and Ms. Olson are not related.
- C. Fiona and Jennifer Lane are sisters. Fiona owns 100 percent of the shares of FL Inc. and 31 percent of Lane Ltd. Her sister Jennifer owns 60 percent of the shares of JL Inc., with the remaining 40 percent of the shares held by her father. Jennifer also owns 39 percent of the shares of Lane Ltd. The remaining shares of Lane Ltd. are held by an unrelated party.
- D. Ms. Garland owns 90 percent of the shares of Garland Inc. She also owns 10 percent of the shares of Newton Ltd. Her 13 year old son Newton owns 10 percent of the shares of Newton Ltd. While the remaining shares of Newton Ltd. are owned by Newton's father, Mr. Isaac, Ms. Garland has options to acquire up to 40 percent of the Newton shares from him. Ms. Garland and Mr. Isaac have never been married or lived in a common-law relationship. They are, however, good friends.
- E. Mr. Barnes owns 70 percent of the shares of Noble Inc. and 24 percent of the shares of Borders Ltd. Noble Inc. owns 40 percent of the shares of Borders Ltd.

**Required:** For each of the preceding situations, indicate whether the corporations are associated and explain your conclusion with reference to the *Income Tax Act*. In order 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.

## TIF PROBLEM FOURTEEN - 10

### Investment Tax Credits

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The following three independent cases involve the tax procedures associated with various types of investment tax credits.

#### **Case A**

In 2015, Carlton Ltd. employed 12 eligible apprentices. The total amount paid to these individuals is \$230,000. Seven of the apprentices are paid \$15,000 for the year, with the remaining five each being paid \$25,000.

Also during 2015, the Company acquires \$1,500,000 in Class 53 assets on which a 10 percent investment tax credit is available.

**Required:** Describe the 2015 and 2016 tax consequences associated with making these expenditures and claiming the related investment tax credits. Include in your solution the CCA for 2015 and 2016.

#### **Case B**

Since its date of incorporation, Lanson Ltd. has always qualified as a Canadian controlled private corporation. For the taxation year ending December 31, 2015, it had Taxable Income of \$652,000. The corresponding figure for 2016 is \$714,000.

Its Taxable Capital Employed In Canada was \$12,300,000 in 2015 and \$13,100,000 in 2016.

**Required:** Determine Lanson's SR&ED annual expenditure limit for the 2016 taxation year.

#### **Case C**

Martin Processes has been a Canadian controlled private corporation since it was established several years ago. In the taxation year ending December 31, 2015, it had Taxable Income of \$32,000. The corresponding figure for 2016 is \$12,000. The Company has no Tax Payable for the taxation year ending December 31, 2016, or for any of the three preceding years.

Its Taxable Capital Employed in Canada is \$11,100,000 in 2015 and \$12,400,000 in 2016.

During 2016, the Company has made a number of expenditures that qualify for investment tax credits:

- \$110,000 for qualified expenditures in the Atlantic Provinces.
- \$3,300,000 in current expenditures for SR&ED.

**Required:** Determine the amount of the refund that Martin Processes will receive as a result of earning these investment tax credits and any available carry forwards. Include in your answer any other tax consequences of these investment tax credits.

## **TIF PROBLEM FOURTEEN - 11**

### **Capital Dividend Account With CEC**

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Braken Ltd. was incorporated in 2005 and, since that time, it has been a Canadian controlled private company. Between the date of its incorporation and December 31, 2016, it has had the following transactions that relate to the Company's capital dividend account.

- In 2006, the Company sold a capital asset with an adjusted cost base of \$73,600 for proceeds of \$114,200.
- In 2009, the Company received a capital dividend of \$42,100.
- In 2011, the Company paid a capital dividend of \$23,100. The required election was made.
- In 2012, the Company sold two parcels of land. The first parcel of land, which had an adjusted cost base of \$123,400, was sold for \$176,200. The second parcel of land, which had an adjusted cost base of \$220,400, was sold for \$198,600.
- In 2013, the Company received life insurance proceeds, net of the adjusted cost base of the policy, in the amount of \$131,600.
- During 2016, the Company sold an unlimited life franchise for \$375,000. This franchise was acquired in 2014 for \$315,000. The Company took maximum amortization in both 2014 and 2015.
- In 2016, the Company paid a capital dividend of \$45,200. The required election was made.

**Required:** Determine the balance in the Company's capital dividend account as of December 31, 2016. Provide a separate calculation of the income inclusion resulting from the sale of the franchise.

## **TIF PROBLEM FOURTEEN - 12**

### **Corporate Surplus Distributions**

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**Required:** Indicate the tax consequences to the relevant shareholders of the transaction(s) described in each of the following **independent** Cases. Tax consequences would include the increase or decrease in the individual shareholder's Taxable Income, any change in the adjusted cost base and/or PUC of any shares that are still in the hands of the individual shareholder after the described transaction(s), and any federal dividend tax credits that result from the described transaction(s). Assume that any dividends that arise are non-eligible.

#### **Case 1**

When Saber Ltd. was incorporated several years ago, 500,000 common shares were issued at a price of \$23 per share, for a total value of \$11,500,000. As the original owner wished to retire, all of the shares were sold to Milly Brant for \$18.60 per share, for a total value of \$9,300,000. The following year, the Company redeemed 125,000 of the Saber Ltd. shares for \$3,200,000.

#### **Case 2**

After liquidating all of its assets and paying off all of its liabilities, a corporation is left with cash of \$2,750,000. The \$2,750,000 is distributed to the corporation's only shareholder, Willie Henry. He has owned the shares for more than 20 years.

The shares of the corporation have a PUC of \$75,000. The balance in the company's capital dividend account at this time is \$243,000, with the company making the appropriate election to distribute this amount as a capital dividend. The adjusted cost base of the shares for Willie is \$463,000. Subsequent to the distribution, the shares are cancelled.

#### **Case 3**

Martha Stew owns all of the outstanding shares of Stew's Brews Ltd. (SBL). SBL is a Canadian controlled private corporation and its shares have a PUC of \$427,000. Their adjusted cost base to Martha Stew is \$562,000. During the current year SBL pays a liquidating dividend of \$152,000. This was accompanied by a PUC reduction of \$78,000.

#### **Case 4**

When Marley Ltd. was formed, it issued 179,000 shares at \$30 per share, a total of \$5,370,000. Robbie Marley purchased 26,850 of these shares at issuance.

A creditor of the Company has agreed to accept 21,000 new Marley Ltd. shares in settlement of debt with a face value of \$700,000. At this time, the shares are valued at \$35 per share.

Shortly after this debt settlement, Robbie Marley sells his shares to an arm's length party for \$37 per share.

## **TIF PROBLEM FOURTEEN - 13**

### **Corporate Surplus Distributions**

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**Required:** Indicate the tax consequences to the relevant shareholders of the transaction(s) described in each of the following **independent** Cases. Tax consequences would include the increase or decrease in the individual shareholder's Taxable Income, any change in the adjusted cost base and/or PUC of any shares that are still in the hands of the individual shareholder after the described transaction(s), and any federal dividend tax credits that result from the described transaction(s). Assume that any dividends that arise are non-eligible.

#### **Case 1**

Marion Scope owns 100 percent of the outstanding shares of Scope Ltd. Scope Ltd. is a Canadian controlled private corporation. The shares of the Company have a PUC \$683,000. As Marion purchased the shares from the original owner after the corporation had been operating for several years, her adjusted cost base is \$723,000.

During the current year, a liquidating dividend of \$223,000 was paid to Marion. This was accompanied by a PUC reduction of \$162,000.

#### **Case 2**

Jason Mark owns 15 percent of the outstanding voting shares of Mark Ltd. These shares were purchased when the Company was formed. At this time, 225,000 shares were sold at a price of \$15, resulting in a total PUC of \$3,375,000.

One of the Company's creditors has agreed to accept 30,000 new Mark Ltd. shares in settlement of debt with a face value of \$550,000. At this time the Mark Ltd. shares are valued at \$20 per share.

Shortly after this time, Jason Mark sells all of his Mark Ltd. shares for \$23 per share.

#### **Case 3**

After liquidating all of its assets and paying off all of its liabilities, a corporation is left with cash of \$1,875,000. The \$1,875,000 is distributed to the corporation's only shareholder, Veronica Venus who has owned the shares for more than 10 years. The shares of the corporation have a PUC of \$125,000. The balance in the company's capital dividend account at this time is \$321,000, with the company making the appropriate election to distribute this amount as a capital dividend. The adjusted cost base of the shares for Veronica is \$364,000. Subsequent to the distribution, the company's shares are cancelled.

#### **Case 4**

At incorporation, Lason Inc. issued 300,000 common shares at \$32 per share, for a total value of \$9,600,000. The original owner later sold these shares to Lawrence Foster for \$28 per share, for a total of \$8,400,000. During the year subsequent to this sale, the Company redeemed 50,000 of these shares for \$1,700,000.

## Chapter Fifteen Test Item File Problems

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### TIF PROBLEM FIFTEEN - 1

#### Management Decisions - Essay Questions

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1. Frank Labelle has an unincorporated business that produces just enough income to meet his personal consumption needs. He anticipates that its income will exceed his consumption needs in the foreseeable future. Will he save taxes by incorporating? Will he defer taxes by incorporating? Explain your conclusions.
2. Briefly describe the two basic types of tax benefits that can arise through the incorporation of a business.
3. One of the advantages that is cited for the use of a corporation is limited liability. Explain this concept and indicate whether you believe that it is an advantage for a small private corporation with a single shareholder.
4. Varying provincial tax rates on corporations and varying provincial dividends tax credits for individuals can result in imperfections in the integration system. Briefly explain how these imperfections can influence the decision to use a corporation to earn business income in 2016.
5. Under what circumstances would income splitting become an effective tax planning strategy? Explain your conclusion.
6. An individual has started a new business. While he is confident that, in the long run, it will be very profitable, he expects the business to incur losses in the first 3 to 5 years of operation. Would you advise this person to operate this business as a proprietorship or, alternatively, incorporate the business?
7. Provinces have sometimes declared a tax holiday (i.e., a period in which no provincial taxes will be assessed) for new Canadian controlled private corporations that start up business operations within their boundaries. The province's objective in granting this tax free period is to encourage economic growth and employment within the province. Describe the impact of such tax holidays on the type of compensation that will be used for the owner-manager of the business. Explain your conclusion.
8. Indicate the conditions that are necessary for integration to work for income flowed through a large public company.
9. What is "bonusing down"? What is the advantage that results from the use of this tax planning technique?
10. Ms. Copeland has invested in the common shares of a number of large Canadian public companies, all of which pay regular dividends that are eligible for the enhanced dividend gross up and tax credit procedures. She has no intention of selling the shares in the foreseeable future. She has asked your advice as to whether there would be either tax deferral or tax savings if she transferred these shares to a private company. She would be the only shareholder of this new company. Ms. Copeland has sufficient other sources of income that she is in the 29 percent federal tax bracket. She lives in a province where her marginal tax rate is 12 percent and the provincial dividend tax credit on both eligible and non-eligible dividends is equal to 25 percent of the dividend gross up.

*Management Decisions - Essay Questions*

11. For an individual in the maximum tax bracket, channeling income through a corporation can result in tax deferral. Depending on corporate tax rates, this may or may not be beneficial to the individual. Explain this statement.
12. For a CCPC paying eligible dividends, perfect integration occurs which the combined federal/provincial corporate tax rate is 27.54 percent and the combined federal/provincial dividend tax credit is equal to the dividend gross up. Briefly explain how rates that differ from these alter the desirability of using a corporation.
13. An individual with no other source of income can receive nearly \$32,000 in non-eligible dividends without incurring any tax liability. In contrast, such an individual would start paying taxes after receiving only \$11,474 in interest income. Explain this difference in treatment of the two types of income for 2016.
14. Jessica Simsung has 2 children over the age of 20. While Ms. Simsung has several million dollars invested in shares of public companies that earn a substantial rate of return through dividends, her children have no income of their own. Ms. Simsung has employment income which places her in the maximum tax bracket. Describe briefly how Ms. Simsung could use a corporation to split income with her children.
15. In making management compensation decisions, how does the owner-manager environment differ from that of a publicly traded company?
16. One of your friends, who is the sole shareholder of a private corporation, has decided that it would be a good idea to have his company pay for a swimming pool at his personal residence. He has concluded that this would be better than paying himself sufficient salary to construct the pool with his own funds. Do you agree? Explain your conclusion.
17. The general rule for shareholder loans is that they must be included in the shareholder's income when received. Indicate two exceptions to this general rule that are available to all shareholders, without regard to whether they are employees as well as shareholders.
18. If the owner-manager of a private corporation is provided with a loan by his corporation to assist in acquiring a residence, he will not have to include the principal amount in income if he can demonstrate that he received the loan in his capacity as an employee, rather than as a shareholder of the corporation. Explain why this may be difficult for him to do.
19. John Brothers is a shareholder of Brothers Ltd. He is also considered to be an employee. Brothers Ltd. provides John with an interest free loan to assist him in purchasing a home after being moved to a new work location. Explain why John would prefer to have his loan benefit assessed to him as an employee, rather than as a shareholder.
20. Provide two examples of management compensation that can either reduce or defer the taxation applicable to a corporation and its shareholders. For each example, explain how the reduction or deferral occurs.
21. List and describe three factors, other than tax reduction and tax deferral, that should be considered by an owner-manager when choosing between salary compensation and the receipt of dividends.
22. Even in situations where provincial tax and dividend tax credit rates favour the use of dividends, owner-managers may retain more after tax income if they receive some part of their compensation in the form of salary. Explain this statement.

## **TIF PROBLEM FIFTEEN - 2**

### **Management Decisions - True Or False**

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#### **New For 2016/2017**

1. An advantage of incorporation is the ability to use business losses against an individual's other sources of income.

True Or False?

2. The use of a corporation can facilitate splitting income with other members of an individual's family.

True Or False

3. For eligible dividends, perfect integration requires that the provincial dividend tax credit be equal to 5/11 of the dividend gross. If the provincial credit is larger than this, the use of a corporation will be less attractive.

True Or False?

4. "Bonusing Down" is a procedure that owner-managers use to defer taxes on the salary amounts that they receive from their corporation.

True Or False?

5. Individuals with no other source of income can receive a substantial amount of dividends on a tax free basis. This is because dividend income uses up an individual's tax credits at a lower rate than is the case with other sources of income.

True Or False?

6. An owner-manager of a construction company would like to have a swimming pool installed at his personal residence. It doesn't really matter whether he has his corporation build it for him or, alternatively pay him sufficient salary to build the pool on his own.

True Or False?

7. Jo Beth Williams works for the Royal Bank and is also a shareholder of the company. The bank has extended her a \$25,000 interest free loan that she can use for any purposes she chooses. Because she is a shareholder, she will have to include the \$25,000 principal of the loan in her Net Income For Tax Purposes.

True Or False?

8. A shareholder loan that is for the purposes of acquiring a personal residence does not have to be included in the shareholder's Net Income For Tax Purposes, provided he has received the loan because he is an employee of the corporation.

True Or False?

9. Any form of compensation that is deductible by the corporation in a fiscal year prior to the year it is included in the income of the shareholder involves tax deferral.

True Or False?

10. If an owner-manager wishes to make contributions to an RRSP, he will prefer to have dividend compensation, rather than salary compensation.

True Or False?

## **Retained From Previous Editions**

11. All other things being equal, higher provincial tax rates on corporations favour the use of a corporation to earn business income.

True or False?

12. In cases where a corporation is subject to a low tax rate (e.g., a combined federal/provincial rate of 12 percent), charitable donations have less value to a corporation than they do to an individual.

True or False?

13. Income splitting refers to procedures which are designed to spread an individual's Taxable Income over several taxation years.

True or False?

14. All other things being equal, a low provincial dividend tax credit favours the use of dividends to compensate the owner/manager of a CCPC.

True or False?

15. If the owner/manager of a CCPC has a large Cumulative Net Investment Loss (CNIL) balance, he should pay himself dividends rather than salary.

True or False?

16. Any resident Canadian individual over the age of 17 can receive over \$30,000 in non-eligible dividends from a CCPC without paying any taxes.

True or False?

**TIF PROBLEM FIFTEEN - 3****Management Decisions - Multiple Choice**

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**New For 2016/2017*****The Decision To Incorporate***

1. Which of the following statements about the use of a corporation is **NOT** correct?
  - A. The use of a corporation is more desirable in a province with a high dividend tax credit.
  - B. The use of a corporation will always result in deferral of taxes on income that is left in the corporation.
  - C. The use of a corporation is less desirable in a province with a low dividend tax credit.
  - D. The use of a corporation is more desirable in a province that has high tax rates on individuals.

***Tax Reduction and Deferral***

2. Joan Barskey acquired 4,500 shares in Barskey Inc., a corporation that is controlled by her family. The cost of these shares was \$900,000. In addition, she has personally guaranteed a bank loan for Barskey Inc. in the amount of \$250,000. If Barskey Inc. goes bankrupt, which of the following statements is correct?
  - A. Joan's financial risk is limited to \$1,150,000.
  - B. Joan's financial risk is limited to \$900,000.
  - C. Joan's financial risk is limited to \$250,000.
  - D. Joan's financial risk is unlimited.

***Provincial Taxes and Integration***

3. Which of the following factors is **NOT** significant in contributing to imperfections in the integration system for corporate taxes?
  - A. Varying provincial rates for the dividend tax credit.
  - B. Varying provincial rates for corporate taxes on CCPCs.
  - C. Differing federal dividend tax rates for eligible and non-eligible dividends.
  - D. Varying provincial rates for corporate taxes on public companies.

***Tax Free Dividends***

4. Which of the following statements with respect to tax free dividends is correct?
  - A. Any individual can receive a significant amount of eligible dividends without the payment of taxes on the amounts received.
  - B. For an individual in the lowest tax bracket, the dividend tax credit will be larger than the Tax Payable on the grossed up dividends.
  - C. To be received on a tax free basis, dividends must be designated as eligible.
  - D. For individuals in the lowest tax bracket, dividends always use up tax credits at a slower rate than other types of income.

***Income Splitting***

5. While of the following statement about income splitting is **NOT** correct?
  - A. For income splitting to be a useful tax planning tool, the related individuals must be in different tax brackets.
  - B. Income splitting can only be accomplished by using a corporation.
  - C. Income splitting can be accomplished by giving shares in an owner-managed corporation to adult children who are in a low tax bracket.
  - D. Income splitting can be accomplished by selling shares in an owner-managed corporation to the owner-manager's spouse.

**Shareholder Loans**

6. The general rule is that loans made to shareholders must be included in the shareholder's income in the year that the proceeds are received. There are, however, a number of exceptions to this rule. Which of the following is **NOT** an exception to the general rule?
- A. A loan to an owner-manager to allow him to purchase a personal residence. The loan does not have a specific repayment date.
  - B. An interest free loan to a shareholder of a bank.
  - C. A loan to an owner-manager to acquire an automobile that he will use in working for the company. The company has no other employees.
  - D. A loan extended to an owner manager that must be repaid within two years. The company has a December 31 year end and the loan is extended on January 1 of the current year.

**Management Compensation**

7. Which of the following types of owner-manager compensation is the least likely to provide either tax deferral or tax savings?
- A. Contributions to a registered pension plan.
  - B. Contributions to a group disability plan
  - C. Granting options to acquire shares in the company.
  - D. Salary payments.

**Retained From Previous Editions****The Decision To Incorporate**

8. Which of the following is **NOT** a possible advantage of incorporating a business?
- A. The ability to defer taxes on income left in the business.
  - B. The ability to absorb business losses against employment income.
  - C. Limiting personal liability to the amount paid for shares.
  - D. The ability to use the lifetime capital gains deduction.
9. Taxpayers decide to incorporate for many reasons. In which of the following situations would there be an advantage to a taxpayer in incorporating a business?
- A. The taxpayer has significant personal losses and is looking for a way to utilize them.
  - B. The taxpayer has significant personal assets and investment income, and does not need all of the cash from her business in order to pay day to day living expenses.
  - C. The taxpayer has significant personal assets and investment income, and needs all of the cash from her business in order to pay day to day living expenses.
  - D. The taxpayer makes significant charitable donations each year and wants to use a corporation to maximize the tax savings from these donations.
10. The use of a corporation is most likely to result in a reduction in total taxes if:
- A. The corporation is a public company earning manufacturing income.
  - B. The corporation is a CCPC earning dividends.
  - C. The corporation is a CCPC earning investment income.
  - D. The corporation is a CCPC earning active business income.

11. There are several benefits to incorporating a business. Which of the following groups of statements about benefits is correct?
- A. Investment income under \$500,000 is eligible for a lower tax rate; dividend payments may be deferred until after a shareholder has retired; and a lifetime capital gains deduction may be available if conditions are met.
  - B. Active business income under \$500,000 is eligible for a lower tax rate; taxable benefits may be provided to the shareholder if he is also an employee; and dividend payments may be deferred until after a shareholder has retired.
  - C. A lifetime capital gains deduction may be available if conditions are met; a tax deferral is available if the shareholder requires the corporation's profits for personal use in the year; and dividend payments may be deferred until after a shareholder has retired.
  - D. Dividend payments may be deferred until after a shareholder has retired; a lifetime capital gains deduction may be available if conditions are met; and active business income under \$500,000 is eligible for a lower tax rate.

### **Tax Reduction and Deferral**

12. Mr. Dawson is considering incorporating a company and transferring some of his assets into this company in order to take advantage of the possibility of some tax savings and deferral possibilities. Which of the following situations would provide the largest tax savings for Mr. Dawson?
- A. Incorporating a CCPC earning only Active Business Income eligible for the small business deduction.
  - B. Incorporating a CCPC earning a 50/50 combination of Active Business Income eligible for the small business deduction and investment income.
  - C. Incorporating a CCPC earning only investment income.
  - D. Incorporating a CCPC earning only dividend income.
13. GMR Inc is a corporation owned 100 percent by Ms. Rothstein. For the current year, the company accountant is predicting that taxable income will exceed \$500,000. The accountant has suggested that Ms. Rothstein should consider paying herself an additional salary to ensure the taxable income of her CCPC will be less than \$500,000. Why?
- A. Because only income eligible for the small business deduction benefits from a modest tax deferral and significant tax savings.
  - B. Because the CRA will never challenge the reasonableness of remuneration to a shareholder, and the accountant must feel that Ms. Rothstein deserves a bonus this year.
  - C. Because if the income over \$500,000 remains in the company it will not benefit from the small business deduction, and therefore after tax retention on this excess income in the company will be lower than it would be on paying a salary to Ms. Rothstein.
  - D. Because the case for "bonusing down" has gotten stronger in the past few years, and it is therefore more important than ever to take advantage of this possibility to save taxes.
14. John is thinking about incorporating his charter boat business. Which of the following describes an advantage that could be associated with incorporating the business as compared to running it as a proprietorship?
- A. John could use any future business losses to offset his taxable employment income.
  - B. John could protect himself from being held personally liable if a client sustained injuries by falling overboard.
  - C. John could hire his brother to pilot the boat on days when he is not available. His brother's salary would be deductible in calculating the corporation's income.
  - D. John will not pay CPP on any salary paid to him by the corporation if he owns more than 40 percent of the voting shares.

*Management Decisions - Multiple Choice*

15. An individual's only source of income is dividends from public companies. He is considering transferring the public company shares to a corporation. If he was to do so, which of the following statements is correct?
- A. There would be a reduction in the total taxes paid.
  - B. There would always be deferral of taxes as long as the dividend income was left in the corporation.
  - C. All of the federal corporate taxes paid on the dividends would be refunded when all of the dividends received by the corporation are paid out to the individual.
  - D. The individual taxes on the dividends would be lower after they have passed through the corporation.
16. With respect to the incorporation of a proprietorship earning less than \$500,000 of active business income, which of the following statements is correct?
- A. Incorporation will always result in an overall reduction in taxes because it combines the small business deduction with the dividend tax credit.
  - B. Incorporation will result in an overall reduction in taxes because corporations are able to deduct many items that cannot be deducted by an unincorporated business.
  - C. Incorporation will result in a deferral of taxes to the extent profits can be left in the corporation.
  - D. Incorporation will be beneficial because it will always limit the shareholders' obligations to creditors.
17. An individual owns a retail business that is unincorporated. The business earns about \$150,000 per year, all of which is needed by the individual for his personal living expenses. The individual is considering incorporating this business. Which of the following statements is correct?
- A. There can be a small tax advantage associated with incorporation.
  - B. The application of the small business deduction will result in a significant reduction in overall taxes.
  - C. The application of the small business deduction will result in a significant deferral of tax payments.
  - D. The application of the gross up and tax credit procedures for dividends will result in a significant reduction in overall taxes.
18. Joan Farnun has employment income of about \$100,000. This employment income is sufficient to cover her personal living expenses. In addition, she operates a consulting business which earns about \$50,000 per year. She is considering the incorporation of the consulting business. With respect to the incorporation, which of the following statements is correct?
- A. There will be an overall tax savings because of the small business deduction.
  - B. There will be an overall tax savings because of the dividend tax credit.
  - C. There will be tax deferral because of the small business deduction.
  - D. There will be no tax deferral because of the integration provisions in the *Income Tax Act*.

**Provincial Taxes and Integration**

19. The use of a corporation to provide tax deferral is most successful when:
- The combined federal/provincial tax rate on corporations is greater than the combined federal/provincial tax rate on individuals.
  - The combined federal/provincial tax rate on corporations is less than the combined federal/provincial tax rate on individuals.
  - The combined federal/provincial tax rate on corporations is equal to the combined federal/provincial tax rate on individuals.
  - The combined federal/provincial dividend tax credit rates add up to 100% of the dividend gross up.
20. Which of the following factors is **NOT** relevant in determining whether a corporation can be used to reduce taxes?
- The combined federal/provincial tax rate on corporations.
  - The combined federal/provincial dividend tax credit.
  - The combined federal/provincial tax rate on individuals.
  - All of the above factors are relevant in determining whether a corporation can be used to reduce taxes.

**Shareholder Loans**

21. A corporation loans a shareholder \$30,000 on April 1, 2016, interest free. The shareholder is not an employee of the corporation. The fiscal year end of the corporation is October 31. Assume the prescribed rate is 2 percent for all years under consideration. For each of the **independent** parts of the question, choose one of the following answers. Each answer can be used more than once.

A. \$450	D. \$30,450
B. \$600	E. \$30,600
C. \$30,000	F. Nil

- The shareholder purchases investment property using the \$30,000. The loan is to be repaid on December 31, 2019. The increase in 2016 Taxable Income of the shareholder due to the loan and the investment of the proceeds is:
- The shareholder purchases investment property using the \$30,000. The loan is to be repaid on April 1, 2017. The increase in 2016 Taxable Income of the shareholder due to the loan and the investment of the proceeds is:
- The shareholder sells his home and purchases another, larger house, in the same neighbourhood, using the \$30,000. The loan is to be repaid on December 31, 2019. The increase in 2016 Taxable Income of the shareholder due to the loan and the use of the proceeds is:

## Management Decisions - Multiple Choice

22. Albert Jay is an employee and 15 percent shareholder of Rick's Welding Shop Ltd. (Rick's). During the 2016 calendar year, Albert Jay was having cash flow problems. Rick's gave Albert Jay a loan of \$5,000 on May 1, 2016 to help him out. Rick's also gave Albert Jay's son, Jake, a loan of \$2,000 on September 30, 2016 to help him meet expenses while at college. Rick's has said that Albert Jay and Jake can repay the loans whenever they can afford it. The loans remain outstanding as at January 31, 2018. Rick's year end for accounting and taxation purposes is December 31.

How much, and in which taxation year, is Albert Jay required to include in his Taxable Income as a result of the above transactions?

- A. \$5,000 - 2016.
  - B. \$5,000 - 2017.
  - C. \$7,000 - 2016.
  - D. \$7,000 - 2017.
  - E. None of the above.
23. Jacquie is the sole shareholder of Holdings Ltd., which has a January 31 year end. On January 1, 2016, Jacquie borrowed \$10,000 on an interest-free basis from Holdings Ltd. She used \$8,000 of this amount to acquire shares of Arrow Inc. and the remaining \$2,000 for personal purposes. Arrow Inc. is a small Canadian controlled private company that manufactures cross-bows. In March 2016, Arrow Inc. paid a non-eligible dividend of \$1,100 to Jacquie. Jacquie repaid her \$10,000 loan to Holdings Ltd. on June 30, 2016. Assume that these were her only transactions with Holdings Ltd. and the prescribed interest rate was 4 percent for the first quarter of 2016 and 3 percent for the second quarter. Which one of the following represents Jacquie's 2016 Taxable Income as a result of these transactions?
- A. \$1,100.00.
  - B. \$1,287.00.
  - C. \$1,321.68.
  - D. \$1,460.42.
24. Paul is one of six shareholders, but not an employee, of a Canadian controlled private corporation that manufactures doors. The corporation has a large amount of cash on hand and the other shareholders have agreed that the corporation can lend him \$200,000 for a few years. To avoid having the principal included in his Taxable Income, the loan must meet which of the following conditions?
- A. Interest must be made at the rate prescribed by the Regulations to the *Income Tax Act*.
  - B. It must be for the purchase of the company's shares.
  - C. It must be repaid within one year of the end of the fiscal year in which it was made.
  - D. It must have a specific repayment date.

25. Martin Locks owns 100 percent of the shares of Locks Inc., a corporation with a December 31 year end. In January 2015, the corporation loans Martin \$350,000 in order to assist him in acquiring a new principal residence. The loan is interest free and will be paid back on January 1, 2017. While small loans are made to other employees of the Company, a loan of this size is only available to Martin. Assume that the prescribed rate is 4 percent throughout 2015 and 5 percent throughout 2016. Which of the following statements is correct?
- A. Martin will have to include \$350,000 in his 2015 Net Income For Tax Purposes.
  - B. Martin will have to include \$14,000 in his Net Income For Tax Purposes in both 2015 and 2016.
  - C. Martin will have to include \$14,000 in his Net Income For Tax Purposes for 2015 and \$17,500 in his Net Income For Tax Purposes for 2016.
  - D. Martin will have an inclusion in his 2015 Net Income For Tax Purposes, only if the loan is not repaid on December 30, 2016.
26. ITA 15(1) deals with situations where a corporation has provided a benefit to a shareholder that does not appear to have a business purpose. Which of the following events would **NOT** require the shareholder to include a benefit in his income?
- A. The corporation provides an interest free loan to the shareholder to allow him to purchase a home suitable for entertaining business clients.
  - B. The shareholder purchases a vehicle that the corporation owns, but is not using, for 50 percent of fair market value.
  - C. The shareholder takes a two week, \$12,000 vacation paid for by the corporation. During the vacation, the shareholder attends a 1 day session on tax issues related to the corporation's business.
  - D. The corporation purchases life insurance on the life of the shareholder in order to ensure that the company has the necessary funds to deal with a sudden, unexpected death of the shareholder.

### **Salary Vs. Dividends**

27. An owner-manager can generally choose whether he wishes to receive compensation in the form of dividends or, alternatively in the form of salary. All other things being equal which of the following would encourage the use of dividends?
- A. A desire to make contributions to an RRSP.
  - B. A low provincial dividend tax credit.
  - C. A desire to eliminate a large CNIL balance.
  - D. A high provincial corporate tax rate.
28. Joan Barts owns all of the outstanding shares of Barts Ltd., a CCPC that is carrying on an active business. She would prefer to pay herself salary instead of dividends if:
- A. The corporation has a large RDTOH balance.
  - B. The corporation is located in a province with a low corporate tax rate.
  - C. The corporation has Taxable Income in excess of \$500,000.
  - D. The corporation is located in a province with a high dividend tax credit.

29. Larry Watts, a Canadian resident, owns 49 percent of the shares of Zatch Ltd., a Canadian corporation. Laura Marsh, who lives in England, owns the remaining 51 percent. For the current year, the corporation has \$150,000 in income, all of which will be paid out as either salary or eligible dividends. Because of other sources of income, Larry is in the 29 percent federal tax bracket and an 18 percent provincial tax bracket. On both eligible and non-eligible dividends, the provincial dividend tax credit is equal to 30 percent of the gross up. Zatch Ltd. pays taxes at a combined federal/provincial rate of 32 percent. With respect to Larry's choice between receiving his share of the after tax corporate income in the form of salary or dividends, which of the following statements is correct?
- A. It does not matter whether he receives salary or dividends as he would retain the same after tax amount with either alternative.
  - B. He should take the salary because he will have more left after tax.
  - C. He should take the dividends because he will have more left after tax.
  - D. In order to fully use his personal tax credits, he should receive a combination of salary and dividends.
30. Sharon Hartly is the owner-manager of a CCPC from which she receives an annual salary of \$70,000 per year. For 2016, after deducting her salary, the CCPC will have additional income of \$150,000. Sharon would like to take additional funds of \$40,000 out of the corporation. Which of the following statements is correct?
- A. The best solution is to take the funds out as salary as this will increase her pensionable earnings for CPP purposes.
  - B. The best solution is to take the funds out as a dividend as this will have the lowest tax cost.
  - C. The best solution is to take the funds out as salary because this will reduce her CNIL balance for purposes of the lifetime capital gains deduction.
  - D. The best solution is to take the funds out as salary so that she can maximize her contribution to her RRSP.

## **TIF PROBLEM FIFTEEN - 4**

### **Management Decisions - Exam Exercises**

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#### ***Exam Exercise Subject Listing For Chapter 15***

<b>Number</b>	<b>Subject</b>
1	Use Of A Corporation For Tax Deferral And Savings
2	Use Of A Corporation For Tax Deferral And Savings)
3	Incorporation Of Interest Income
4	Incorporation Of Interest Income
5	Incorporation Of Interest And Dividends
6	Incorporation Of Interest And Dividends
7	Incorporation Of Capital Gains
8	Incorporation Of Capital Gains
9	Shareholder Loans
10	Shareholder Loans
11	Salary Compensation
12	Salary Compensation
13	Dividend Compensation
14	Dividend Compensation
15	Salary Vs. Dividend
16	Salary Vs. Dividend
17	Salary Vs. Dividend
18	Salary Vs. Dividend

**Exam Exercise Fifteen - 1 (Use Of A Corporation For Tax Deferral And Savings)**

Stephen Lee has an unincorporated business that he anticipates will have active business income of \$98,000 for the taxation year ending December 31, 2016. Mr. Lee has employment income in excess of \$800,000 with additional amounts subject to a provincial tax rate of 16 percent. The provincial dividend tax credit is equal to 8/29 of the dividend gross up for non-eligible dividends. Also in this province, the corporate tax rate is 4.5 percent on income eligible for the small business deduction and 15 percent on other income.

Mr. Lee has asked your advice as to whether he should incorporate this business. Advise him with respect to any tax deferral that will be available on income left in the corporation and on any tax savings that will be available if all of the income is paid out in dividends.

**Exam Exercise Fifteen - 2 (Use Of A Corporation For Tax Deferral And Savings)**

Wanda Ho has employment income in excess of \$300,000 per year. Because of this, any additional income that she receives will be subject to a combined federal/provincial tax rate of 51 percent. Several years ago, she established an unincorporated business that she anticipates will have active business income of \$142,000 for the taxation year ending December 31, 2016.

In her province of residence:

- the corporate tax rate is 3.5 percent on income eligible for the small business deduction
- the corporate tax rate is 11 percent on other income
- the dividend tax credit is 20 percent of the dividend gross up for non-eligible dividends
- the dividend tax credit is 30 percent of the dividend gross up for eligible dividends

Ms. Ho has asked your advice as to whether she should incorporate this business. Advise her with respect to any tax deferral that will be available on income left in the corporation and on any tax savings that will be available if all of the income is paid out in dividends.

**Exam Exercise Fifteen - 3 (Incorporation Of Interest Income)**

Ms. Shauna MacDonald has investments that she anticipates will earn interest income of \$143,000 for the year ending December 31, 2016. She has employment income in excess of \$300,000 with additional amounts subject to a provincial tax rate of 18 percent.

In her province of residence:

- the corporate tax rate is 5 percent on income eligible for the small business deduction
- the corporate tax rate is 14 percent on other income
- the dividend tax credit is 25 percent of the dividend gross up for non-eligible dividends

Ms. MacDonald has asked your advice as to whether she should transfer these investments to a corporation in which she would own all of the shares. Advise her with respect to any tax deferral that could be available on income left in the corporation and on any tax savings that could be available if all of the income is paid out in dividends.

**Exam Exercise Fifteen - 4 (Incorporation Of Interest Income)**

Victor Vice is a very conservative investor who only invests in fixed income securities. He anticipates that he will have interest income of \$210,000 for the year ending December 31, 2016. As he has employment income of more than \$400,000 per year, any additional income is taxed at a combined federal/provincial rate of 51 percent.

In his province of residence:

- the corporate tax rate is 2.5 percent on income eligible for the small business deduction
- the corporate tax rate is 13 percent on other income
- the dividend tax credit is 30 percent of the dividend gross up for non-eligible dividends

Mr. Vice has asked your advice as to whether he should transfer his interest bearing investments to a corporation in which he would own all of the shares. Advise him with respect to any tax deferral that could be available on income left in the corporation and on any tax savings that could be available if all of the income is paid out in dividends.

**Exam Exercise Fifteen - 5 (Incorporation Of Interest And Dividends)**

One of your clients has asked your advice on whether she should transfer a group of investments to a new corporation that can be established to hold them. The corporation will be a Canadian controlled private corporation and she anticipates that the transferred investments will have the following amounts of income for the year ending December 31, 2016:

Non-Eligible Dividends On Portfolio Investments	\$39,000
Non-Eligible Dividends From 100 Percent Owned Subsidiary (A Dividend Refund Of \$20,000 Will Be Received by The Payor)	75,000
Interest Income	36,500

Your client has business income of over \$250,000. She needs all of the income that is produced by these investments to purchase art for her cherished collection. On additional amounts, your client is subject to a provincial tax rate of 16 percent.

In her province of residence:

- the corporate tax rate is 3.5 percent on income eligible for the small business deduction
- the corporate tax rate is 12 percent on other income
- the dividend tax credit is 25 percent of the dividend gross up for non-eligible dividends

Provide the requested advice, including an explanation of your conclusions.

**Exam Exercise Fifteen - 6 (Incorporation Of Interest And Dividends)**

Maximilian Maximus has employment income in excess of \$300,000. This means that any additional income will be taxed at a combined federal/provincial rate of 49 percent.

For the year ending December 31, 2016, in addition to his employment income, Max has the following amounts of investment income:

Interest Income	\$ 71,000
Non-Eligible Dividends - Portfolio Investments	102,000
Non-Eligible Dividends From A 100 Percent Owned CCPC (The CCPC Receives A Dividend Refund Of \$23,000)	96,000

Because of his extensive use of recreational drugs, Max requires all of the income that is produced by these investments (and then some).

In his province of residence:

- the corporate tax rate is 2.5 percent on income eligible for the small business deduction
- the corporate tax rate is 12 percent on other income
- the dividend tax credit is 8/29 percent of the dividend gross up for non-eligible dividends

Max has asked your advice as to whether there would be any tax benefits associated with transferring his investments to a corporation. Provide the requested advice, including an explanation of your conclusions.

**Exam Exercise Fifteen - 7 (Incorporation Of Capital Gains)**

Sandra Peterson has asked your advice on whether she should transfer a group of investments to a new corporation that can be established to hold them. The corporation will be a Canadian controlled private corporation and she anticipates that, during 2016, the market value of these investments will increase by \$142,000. No other income will be generated by the investments. Sandra will sell these investments by the end of the year in order to purchase a condo. None of these investments are eligible for the lifetime capital gains deduction.

The corporation will be subject to a provincial tax rate of 5 percent on income eligible for the small business deduction and 16 percent on other income. Sandra has employment income in excess of \$250,000 and, given this, any additional income will be taxed at a provincial tax rate of 18 percent. The provincial dividend tax credit is equal to 8/29 of the dividend gross up for non-eligible dividends. Provide the requested advice, including an explanation of your conclusions.

**Exam Exercise Fifteen - 8 (Incorporation Of Capital Gains)**

On January 1, 2016, Saul Barkin owns a group of shares with an adjusted cost base of \$420,000. While these shares do not pay dividends, he expects that, during the coming year, their fair market value will increase to \$640,000. At that point he expects to sell the securities in order to purchase a sailboat. None of these investments are eligible for the lifetime capital gains deduction.

Saul has employment income in excess of \$250,000 and, given this, any additional income will be taxed at a combined federal/provincial rate of 52 percent.

He would like your advice on whether there would be any tax advantages associated with transferring these securities to a corporation.

In his province of residence:

- the corporate tax rate is 3.5 percent on income eligible for the small business deduction
- the corporate tax rate is 14 percent on other income
- the dividend tax credit is 25 percent of the dividend gross up for non-eligible dividends

Provide the requested advice, including an explanation of your conclusions.

**Exam Exercise Fifteen - 9 (Shareholder Loans)**

Ms. Janice Thiessen is an employee of Thiessen Ltd., a large company in which her husband owns 60 percent of the outstanding shares. Ms. Thiessen owns the remaining 40 percent of the shares. Thiessen Ltd. has a December 31 year end. It is the policy of the Company to provide an interest free loan of up to \$25,000 to any employee who wishes to acquire a new home. They do not provide loans for home furnishings to employees.

On April 1 of the current year, Ms. Thiessen receives a \$25,000 interest free loan from the Company to purchase a new home. The loan does not qualify as a home relocation loan. On the same day, she receives an additional \$15,000 interest free loan to purchase furnishings for the home. Both loans are to be repaid in four annual instalments to be made on March 31 of each year. Assume the prescribed rate for the current year is 2 percent. What are the current year tax implications of these loans for Ms. Thiessen?

**Exam Exercise Fifteen - 10 (Shareholder Loans)**

Jonathan Baxter owns all of the shares of Baxter Ltd. The Company has a December 31 year end. He also works full time as an employee of the business. It is the policy of the Company to provide every employee an interest free loan of up to \$30,000 to acquire a vehicle that will be used in their employment duties. The loan must be repaid 3 years after the date of borrowing.

On January 1, 2016, Jonathan borrows \$30,000 on an interest free basis. The funds are used to acquire a vehicle to be used in his employment duties. In addition, on July 1, 2016, he borrows \$250,000 on an interest free basis in order to assist in the purchase of a new and larger residence. The Company does not provide house acquisition loans to its other employees. The loan will be repaid in full on July 1, 2019+. Assume that the prescribed rate for all of 2016 is 2 percent. What are the tax implications of these loans for Mr. Baxter for 2016?

**Exam Exercise Fifteen - 11 (Salary Compensation)**

Cloister Inc. is a Canadian controlled private corporation with a December 31 year end. For the 2016 taxation year, Cloister Inc. has Taxable Income, before consideration of dividends or salary paid to its sole shareholder, of \$197,000. All of its income has always been from active business activities. The cash balance of the Company, prior to any payments on the current year's taxes, is also equal to this amount.

Its only shareholder, Ms. Sally Cloister, has no income other than the dividends or salary paid by the corporation and has combined personal tax credits of \$3,375.

In her province of residence, assume:

- The corporate tax rate is 5 percent on income eligible for the small business deduction.
- The corporate tax rate is 14 percent on other income.
- Personal provincial Tax Payable on the first \$140,388 is \$15,500. The rate on additional amounts is 12 percent.
- The dividend tax credit is 8/29 of the dividend gross up for non-eligible dividends.

Determine the amount of after tax cash that Ms. Cloister will retain if the maximum salary is paid by the corporation out of the available cash of \$197,000. Ignore CPP contributions and the Canada employment tax credit.

**Exam Exercise Fifteen - 12 (Salary Compensation)**

Lisgar Ltd. is a CCPC with a December 31 year end. For the 2016 taxation year, it has Taxable Income, before consideration of dividends or salary paid to its sole shareholder, of \$325,000. All of this income is from active business activities. Its available cash balance is also equal to \$325,000.

Harry Lisgar is the only shareholder of Lisgar Ltd. His only income is either salary or dividends from Lisgar Ltd and he has tax credits of \$4,550.

In his province of residence, assume:

- The corporate tax rate is 3.5 percent on income eligible for the small business deduction.
- The corporate tax rate is 13 percent on other income.
- Personal provincial Tax Payable on the first \$200,000 is \$27,000. The rate on additional amounts is 15 percent.
- The dividend tax credit is 25 percent of the dividend gross up for non-eligible dividends.

Determine the amount of after tax cash that Mr. Lisgar will retain if the maximum salary is paid by the corporation out of the available cash of \$325,000. Ignore CPP contributions and the Canada employment tax credit.

**Exam Exercise Fifteen - 13 (Dividend Compensation)**

Cloister Inc. is a Canadian controlled private corporation with a December 31 year end. For the 2016 taxation year, Cloister Inc. has Taxable Income, before consideration of dividends or salary paid to its sole shareholder, of \$197,000. All of its income has always been from active business activities. The cash balance of the Company, prior to any payments on the current year's taxes, is also equal to this amount.

Its only shareholder, Ms. Sally Cloister, has no income other than the dividends or salary paid by the corporation and has combined personal tax credits of \$3,375.

In her province of residence, assume:

- The corporate tax rate is 5 percent on income eligible for the small business deduction.
- The corporate tax rate is 14 percent on other income.
- Personal provincial Tax Payable on the first \$140,388 is \$15,500. The rate on additional amounts is 12 percent.
- The dividend tax credit is 8/29 of the dividend gross up for non-eligible dividends.

Determine the amount of after tax cash that Ms. Cloister will retain if the maximum dividend is paid by the corporation out of the available cash of \$197,000.

**Exam Exercise Fifteen - 14 (Dividend Compensation)**

Lisgar Ltd. is a CCPC with a December 31 year end. For the 2016 taxation year, it has Taxable Income, before consideration of dividends or salary paid to its sole shareholder, of \$325,000. All of this income is from active business activities. Its available cash balance is also equal to \$325,000.

Harry Lisgar is the only shareholder of Lisgar Ltd. His only income is either salary or dividends from Lisgar Ltd and he has tax credits of \$4,550.

In his province of residence, assume:

- The corporate tax rate is 3.5 percent on income eligible for the small business deduction.
- The corporate tax rate is 13 percent on other income.
- Personal provincial Tax Payable on the first \$200,000 is \$27,000. The rate on additional amounts is 15 percent.
- The dividend tax credit is 25 percent of the dividend gross up for non-eligible dividends.

Determine the amount of after tax cash that Mr. Lisgar will retain if the maximum dividend is paid by the corporation out of the available cash of \$325,000.

**Exam Exercise Fifteen - 15 (Salary Vs. Dividend - Limited Corporate Cash)**

For the year ending December 31, 2016, Ramsden Inc. has Taxable Income, before consideration of dividends or salary paid to its sole shareholder, of \$23,600. The Company's cash balance, prior to the payment of any taxes for the year is \$17,300. The Company's Taxable Income is subject to a combined federal/provincial tax rate of 15 percent. There is no payroll tax in this province.

Ms. Ramsden, the Company's president and sole shareholder has no other source of income. She has combined federal/provincial personal tax credits of \$4,120 and lives in a province that has a personal tax rate on the first \$45,282 of Taxable Income equal to 11 percent. The provincial dividend tax credit is 30 percent of the gross up for non-eligible dividends. Ms. Ramsden would like to remove all of the cash from the corporation and has asked you to determine whether it would be better to take it out in the form of all non-eligible dividends or all salary. Ignore the required CPP contributions and the Canada employment tax credit.

**Exam Exercise Fifteen - 16 (Salary Vs. Dividend)**

For the taxation year ending December 31, 2016, Daly Inc. has Taxable Income, before consideration of dividends or salary paid to its sole shareholder, of \$34,500. The Company's cash balance, prior to the payment of any salary or dividends is \$35,200. For the taxation year ending December 31, 2015, Daly Inc. had Net Income For Tax Purposes and Taxable Income of \$12,700. The Company is subject to a combined federal/provincial tax rate of 13 percent on all of its Taxable Income for both 2015 and 2016.

Bryan Daly, the sole shareholder of Daly Inc., has employment income of over \$250,000, and because of this, any additional income will be taxed at a combined federal/provincial rate of 51 percent. The provincial dividend tax credit is equal to 20 percent of the gross up for non-eligible dividends. Mr. Daly has indicated that he would like to remove all of the \$35,200 in cash from his Company and has asked you to determine whether it would be better to take it out in the form of all non-eligible dividends or all salary.

**Exam Exercise Fifteen - 17 (Salary Vs. Dividend)**

For the year ending December 31, 2016, Hughes Ltd. has Taxable Income, before consideration of dividends or salary paid to its sole shareholder, of \$175,000. The Company's cash balance is over \$300,000. It is subject to a combined federal/provincial tax rate of 14 percent. Mr. Hughes, the Company's only shareholder, has employment income of over \$200,000 and, under normal circumstances, does not make withdrawals from the corporation. However, because of a newfound appreciation of casino gambling, he needs an additional \$17,000 in cash.

Mr. Hughes lives in a province where the provincial tax rate in his bracket is equal to 16 percent and the provincial dividend tax credit is equal to 23 percent of the dividend gross up for non-eligible dividends. He has asked your advice as to whether the payment of salary or, alternatively, the payment of non-eligible dividends, would have the lower tax cost. Provide the requested advice.

**Exam Exercise Fifteen - 18 (Salary Vs. Dividend)**

Miriam Foster has employment income in excess of \$300,000. This means that any additional income that she receives will be taxed at a combined federal/provincial tax rate of 51 percent. Because of some very bad real estate investments, she finds that, in addition to her employment income, she needs an additional \$50,000 in cash during the coming year.

She is the sole shareholder of Foster Enterprises, a Canadian controlled private corporation. It is expected that, for the year ending December 31, 2016, Foster Enterprises will have Taxable Income, before consideration of dividends or salary paid to its sole shareholder, of \$225,000. All of this Taxable Income is subject to tax at a combined federal/provincial rate of 14 percent. While Ms. Foster does not normally remove funds from the Company, it has sufficient cash reserves to pay any amount of required salary or dividends.

Ms. Foster has asked your advice as to whether it would be more tax efficient to acquire the required after tax amount of \$50,000 by having the corporation pay her non-eligible dividends or, alternatively, pay her salary. In her province of residence, the provincial dividend tax credit is equal to 5/18 of the gross up on non-eligible dividends.

Provide the requested advice.

## **TIF PROBLEM FIFTEEN - 5A**

### **Management Decisions - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 15, "Corporate Taxation And Management Decisions".

- A. Active Business Income
- B. Bonusing Down
- C. Estate Planning
- D. Income Splitting
- E. Integration
- F. Limited Liability
- G. Low Rate Income Pool
- H. Tax Planning

The following list contains ten potential definitions for the preceding key terms.

1. Tax planning directed towards the distribution of an individual's property at death.
2. A notional account that tracks amounts of a CCPC's income that can be used for the payment of eligible dividends.
3. The undertaking of legitimate transactions or arrangements with a view to avoiding or minimizing the payment of taxes.
4. An approach to the taxation of corporations that attempts to ensure that amounts of income that are flowed through a corporation to its individual shareholders, are subject to the same amount of tax as would be the case if the individuals had received the income directly from its source.
5. Income earned by a business carried on by a taxpayer, other than a specified investment business or a personal services business.
6. A notional account that tracks amounts of a non-CCPC's income that cannot be used for the payment of eligible dividends.
7. A balance that includes net taxable capital gains for the year reduced by any net capital loss carry overs deducted in the year, plus interest income, rents, and royalties.
8. A reference to the fact that the liability of investors in equity shares of a corporation is limited to the amount of their invested capital.
9. A process of paying deductible salary to the owner-manager of a CCPC, or related parties, in order to eliminate corporate taxable income that is not eligible for the small business deduction.
10. A group of tax planning techniques designed to divide a given stream of income among family members or other related parties.

*Management Decisions - Key Term Matching (Easy)*

11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM FIFTEEN - 5B****Management Decisions - Key Term Matching (Moderate)**

**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 15, "Corporate Taxation And Management Decisions".

- A. Active Business Income
- B. Bonusing Down
- C. Estate Planning
- D. Income Splitting
- E. Integration
- F. Limited Liability
- G. Low Rate Income Pool
- H. Tax Planning

The following list contains 14 potential definitions for the preceding key terms.

1. Tax planning directed towards the distribution of an individual's property at death.
2. A process whereby bonuses are declared by a corporation in one year and paid to the owner-manager of a CCPC in a subsequent year. The objective of this process is tax deferral.
3. A notional account that tracks amounts of a CCPC's income that can be used for the payment of eligible dividends.
4. A reference to corporate shares that have a specific provision added that limits the liability of the holder to the amount of his equity investment.
5. The undertaking of legitimate transactions or arrangements with a view to avoiding or minimizing the payment of taxes.
6. An approach to the taxation of corporations that attempts to ensure that amounts of income that are flowed through a corporation to its individual shareholders, are subject to the same amount of tax as would be the case if the individuals had received the income directly from its source.
7. The use of a group of related corporations to divide a single source of income into separate components for purposes of maximizing the small business deduction.
8. Income earned by a business carried on by a taxpayer, other than a specified investment business or a personal services business.
9. A notional account that tracks amounts of a non-CCPC's income that cannot be used for the payment of eligible dividends.
10. A balance that includes net taxable capital gains for the year reduced by any net capital loss carry overs deducted in the year, plus interest income, rents, and royalties.

*Management Decisions - Key Term Matching (Moderate)*

11. A reference to the fact that the liability of investors in equity shares of a corporation is limited to the amount of their invested capital.
12. An approach to the taxation of corporations that attempts to ensure that amounts of income that are flowed through a corporation to all of its shareholders, are subject to the same amount of tax as would be the case if the shareholders had received the income directly from its source.
13. A process of paying deductible salary to the owner-manager of a CCPC, or related parties, in order to eliminate corporate taxable income that is not eligible for the small business deduction.
14. A group of tax planning techniques designed to divide a given stream of income among family members or other related parties.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM FIFTEEN - 6**

### **Flow Through Of Interest Income**

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Ms. Griet Naidu has \$175,000 in cash that she does not currently require for personal expenses. As she has employment income of over \$180,000, her marginal federal tax rate is 29 percent. At this income level, the applicable provincial rate is 16 percent. The provincial dividend tax credit for non-eligible dividends is 30 percent of the gross up.

In her province of residence, the combined federal/provincial rate on investment income earned by a CCPC is 50-2/3 percent. This includes the ITA 123.3 refundable tax on investment income.

Ms. Naidu would like to invest her \$175,000 for the year ending December 31, 2016 in a debt security that pays interest of 3 percent per annum. Her only investment income for the year will be the \$5,250 of interest that she will receive on this security.

**Required:** Prepare calculations that will compare the after tax retention of income that will accrue to Ms. Naidu for 2016 if:

- A. The investment is owned by her as an individual.
- B. The investment is owned by a corporation in which she is the sole shareholder, and which pays out all available income in dividends.

## **TIF PROBLEM FIFTEEN - 7**

### **Flow Through Of Dividend Income**

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Ms. Martha Abdul is employed by a large public company and has an annual salary of \$225,000. The following facts relate to her province of residence:

- The highest marginal tax rate on individuals is 19 percent.
- The provincial dividend tax credit on eligible dividends is equal to 28 percent.
- The provincial tax rate on the investment income of CCPCs is 12 percent.

On the first lottery ticket she had ever bought, Ms. Abdul won \$400,000 in the provincial lottery. As she has no current need for these funds and is not keen on investment risk, she intends to invest the full amount in preferred shares that pay eligible dividends of 5.5 percent annually for the year ending December 31, 2016. She will not have any other investment income during the year.

**Required:** Prepare calculations that will compare the after tax retention of income that will accrue to Ms. Abdul in 2016 if:

- A. The investment is owned by her as an individual.
- B. The investment is owned by a CCPC in which she is the sole shareholder, and which pays out all available income in eligible dividends.

## **TIF PROBLEM FIFTEEN - 8**

### **Flow Through Of Interest Income**

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As an employee of a public company, Carol Henderson has an annual salary of \$175,000.

After years of purchasing losing tickets, Carol wins \$600,000 in the provincial lottery. As her employment income is more than adequate for her current needs, she plans to invest all of these winnings in a debt security for the year ending December 31, 2016. The security pays annual interest at a rate of 4 percent.

The following information is applicable to the province in which Carol is a resident:

- The maximum tax rate for individuals is 14 percent.
- The provincial dividend tax credit on non-eligible dividends is 24 percent of the gross up.
- The provincial tax rate on the investment income of CCPCs is 13 percent.

Other than the interest earned on her investment in the debt security, Carol has no other source of investment income.

**Required:** Prepare calculations that will compare the after tax retention of income that will accrue to Carol for 2016 if:

- A. The investment is owned by her as an individual.
- B. The investment is owned by a CCPC in which she is the sole shareholder, and which pays out all available income in dividends.

## **TIF PROBLEM FIFTEEN - 9**

### **Flow Through Of Dividend Income**

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As an employee of a public company, Carol Henderson has an annual salary of \$175,000.

After years of purchasing losing tickets, Carol wins \$600,000 in the provincial lottery. As her employment income is more than adequate for her current needs, she plans to invest all of these winnings in preferred shares for the year ending December 31, 2016. These securities pay eligible dividends of 5 percent each year.

The following information is applicable to the province in which Carol is a resident:

- The maximum tax rate for individuals is 14 percent.
- The provincial dividend tax credit on eligible dividends is 24 percent of the gross up.
- The provincial tax rate on the investment income of CCPCs is 13 percent.

Other than the preferred share dividends, Carol has no other source of investment income.

**Required:** Prepare calculations that will compare the after tax retention of income that will accrue to Carol in 2016 if:

- A. The investment is owned by her as an individual.
- B. The investment is owned by a CCPC in which she is the sole shareholder, and which pays out all available income in eligible dividends.

## **TIF PROBLEM FIFTEEN - 10**

### **Partner As Individual Or Corporation**

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Harold Bates is an interior decorator. He lives in a province where the provincial on the first \$140,388 of Taxable Income is \$11,500. Amounts in excess of this will be taxed at a provincial rate of 12 percent. In his province, the provincial dividend tax credit is equal to 30 percent of the gross up on both eligible and non-eligible dividends.

After many years of successfully operating as an individual proprietor, Harold has decided to join Mega Designs as the firm's fourth partner. He will become a partner on January 1, 2016. During the partnership's taxation year ending December 31, 2016, it will have Taxable Income of \$620,000. All of this income will be active business income and Harold or his corporation will be entitled to 25 percent of the total.

Harold is considering three different approaches to structuring his participation in the Mega Designs partnership:

**Approach 1** Harold will join the partnership as an individual. His share of the partnership income will be taxed as business income.

For Alternatives 2 and 3, Harold will establish a new corporation and this corporation will become a member of the partnership. Assume that the new corporation is not a personal services business. The corporation will be a CCPC. Its share of the small business deduction will be \$125,000 [(25%)(500,000)].

**Approach 2** This corporation will pay corporate tax on its full share of the partnership income, with the after tax funds being paid to Harold as dividends.

**Approach 3** In this alternative, Harold will receive sufficient salary to reduce the corporation's income to its \$125,000 share of the annual business limit. Corporate taxes will be paid on the remaining Taxable Income.

If a corporation is formed, it would be subject to combined federal/provincial taxes on income eligible for the small business deduction at a rate of 14 percent and on other active business income at a rate of 28 percent.

Because he has no other source of income, he requires all of the income that is generated by his participation in the Mega Designs partnership.

**Required:** Calculate the after tax personal retention of Harold's share of the partnership income for each of the three approaches. Ignore CPP considerations and the Canada employment tax credit in your calculations. Which approach would you recommend based on your analysis?

## **TIF PROBLEM FIFTEEN - 11**

### **Incorporation Of Investment Income**

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Judith Hughes owns an investment portfolio that will generate the following Canadian source income for the current year:

Interest	\$12,000
Capital Gains	30,000
Eligible Portfolio Dividends	40,000

She estimates that her Taxable Income for this year from other sources will be over \$200,000. Her combined federal/provincial rate on additional interest income or taxable capital gains is 52 percent.

Her combined federal/provincial tax rate on dividends received, taking into consideration the relevant gross up and tax credit amounts, are as follows:

Eligible Dividends Received	30 percent
Non-Eligible Dividends Received	40 percent

You are a tax consultant and Judith is meeting with you to find out how she can minimize her next year's Tax Payable. Should she form a holding company and transfer some or all of the investments into the company? Alternatively, should Judith continue to hold any, or all, investments personally?

The federal/provincial corporate tax rate applicable to the investment income of a CCPC is 51-2/3 percent. This includes the ITA 123.3 refundable tax on aggregate investment income. Judith would like you to assume that, if the investments are transferred to her corporation, the corporation will pay out all available funds as dividends.

**Required:**

- A. Assume that Judith does not form a holding company and continues to hold all the investments personally. For each investment, calculate the amount of after tax cash she would retain for the current year.
- B. For each investment, describe how the investment income earned would be taxed if her investments were transferred to a CCPC. Based on this information, indicate whether she should transfer any of these investments to a CCPC or, alternatively, continue to hold them personally.

## TIF PROBLEM FIFTEEN - 12

### Shareholder Loans

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All of the shares of Dez Inc. are owned by Ms. Hannah Fernandez. Dez Inc. is a Canadian controlled private corporation with a taxation year that ends on December 31. In addition to being the sole shareholder of Dez Inc., Hannah works full time in the business.

Dez Inc. has established generous benefit policies in order to retain its employees. All of its employees who have more than 12 months of service are entitled to interest free loans as follows:

- The Company will provide a loan of up to \$200,000 to assist an employee in acquiring a residence. The principal amount of the loan must be repaid at the end of five years.
- The Company will provide a loan of up to \$25,000 to assist an employee in acquiring an automobile that will be used to carry out employment duties. These loans must be repaid within three years.

During the year ending December 31, 2016, Hannah received loan proceeds from her Company as follows:

1. On February 28, Hannah borrows \$200,000 in order to purchase a new residence. The loan is interest free. The loan will be repaid in two annual instalments of \$100,000, beginning on March 1, 2017. It does not qualify as a home relocation loan.
2. On May 1, Hannah borrows \$185,000 to acquire a foreign sports car. She will use it for personal activities only. The loan bears interest at an annual rate of 1 per cent and will be repaid on May 1, 2021.
3. On July 1, Hannah borrows \$40,000 to cover corrective back surgery in a U.S. hospital. The procedure will significantly relieve her back pain and is not available in Canada. The loan is interest free and will be repaid on June 30, 2017.
4. On August 1, Hannah borrows \$100,000 in order to acquire furniture for her new residence. The loan is interest free and will be repaid on August 1, 2018.
5. On October 1, Hannah borrows \$18,000 from her company to finance a much needed week at a luxurious resort in British Columbia. Since she has already borrowed a significant amount of funds, she decides the loan will bear interest at 3 percent. It will be repaid on September 1, 2017.

All repayments and interest payments are made as scheduled. In all of the years under consideration, assume the relevant prescribed rate is 2 percent.

#### Required:

- A. Indicate the tax consequences that will accrue to Hannah as a result of receiving these loans. Briefly explain your conclusions for each loan for the years it is outstanding. Base your interest calculations on the number of months the loans are outstanding.
- B. Identify any tax planning issues that are associated with these loans.

## TIF PROBLEM FIFTEEN - 13

### Shareholder Loans

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Marian Copps owns 100 percent of the shares of outstanding shares of Copp's Copper Ltd., a Canadian controlled private corporation that specializes in producing copper artifacts for various religious organizations. Ms. Copps is the top salesperson at Copp's Copper Ltd.

The Company has an October 31 year end. It is known for its generous treatment of its employees. This includes the extension of low-interest loans to all employees with more than 2 years of service with the Company. More specifically, the Company will:

- Provide a loan of up to \$150,000 to assist an employee in acquiring a residence. When granted, such loans bear interest at 1 percent and must be repaid at the end of five years.
- Provide a loan of up to \$30,000 to assist an employee in acquiring an automobile that will be used in their employment duties. As with the home purchase loans, these loans bear interest at 1 percent and must be repaid at the end of five years.

During the calendar year ending December 31, 2016, Ms. Copps received loan proceeds from her company as follows:

1. On January 31, Ms. Copps borrows \$150,000 in order to purchase a new residence. The loan bears interest at an annual rate of 1 percent. The loan will be repaid in two annual instalments of \$75,000, beginning on February 1, 2017. It does not qualify as a home relocation loan.
2. On March 1, Ms. Copps borrows \$349,000 to acquire a new Ferrari F12. She will use it to cut down the driving time to and from her cottage. The loan bears interest at an annual rate of 1 per cent and will be repaid on March 1, 2021.
3. On June 1, Ms. Copps borrows \$35,000 to cover cosmetic surgery procedures that will enhance her appearance. The loan is interest free and will be repaid on May 31, 2017.
4. On July 1, Ms. Copps borrows \$100,000 in order to stock the wine cellar of her new residence. The loan is interest free and will be repaid on July 1, 2018.
5. On November 1, Ms. Copps borrows \$25,000 from her company to finance a much needed week at a luxurious health spa. Since she has already borrowed a significant amount of funds, she decides the loan will bear interest at 3 percent. It will be repaid on October 1, 2018.

All repayments are made as scheduled. In all of the years under consideration, assume the relevant prescribed rate is 2 percent.

#### Required:

- A. Indicate the tax consequences that will accrue to Ms. Copps as a result of receiving these loans. Briefly explain your conclusions for each loan for the years it is outstanding. Base your interest calculations on the number of months the loans are outstanding.
- B. Identify any tax planning issues that are associated with these loans.

**TIF PROBLEM FIFTEEN - 14****Salary Vs. Dividend Decisions - Required Amount**

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Jeannette Gutierrez is the sole shareholder of Gutierrez Inc., a Canadian controlled private corporation. All of its income qualifies for the small business deduction and, in the province where its activities are located, the combined federal/provincial rate on such income is 14 percent.

Jeannette's income places her in the 33 percent federal tax bracket. Her marginal tax rate on additional income at the provincial level is 19 percent, resulting in a combined rate of 52 percent. The dividend tax credit in her province for non-eligible dividends is 29 percent of the dividend gross up.

During the taxation year ending December 31, 2016, Jeannette expects Gutierrez Inc. to have Net Income For Tax Purposes of \$229,000. This is after a deduction of \$212,000 that is paid to her as salary.

Jeannette needs an additional \$25,000 in cash in order to pay for renovations to her principal residence. Gutierrez Inc. has sufficient cash to pay either additional salary or additional dividends in order to provide the required funds. The Company has no balance in its GRIP account.

**Required:** Determine the amount that would be required in the way of salary and in the way of dividends, in order to provide Jeannette with the required after tax funds of \$25,000. Which alternative would have the lowest tax cost to Jeannette and her corporation?

**TIF PROBLEM FIFTEEN - 15****Salary Vs. Dividend Decisions - Optimum Mix**

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Waylon Salas is the only shareholder of Wasal Inc., a Canadian controlled private company. For the taxation year ending December 31, 2016, the Company has Taxable Income, before any consideration of salary to Waylon or the payment of dividends, of \$135,000. All of this income qualifies for the small business deduction.

Despite its Taxable Income of \$135,000, repayment of a large loan has left Wasal Inc. with only \$54,000 in cash that can be used to pay taxes, salaries, or dividends.

Waylon's only source of income is either dividends or salary from Wasal Inc. For 2016, he has available tax credits of \$4,200 (combined federal and provincial).

Relevant information with respect to his current province of residence is as follows:

- The tax rate for individuals on the first \$45,282 of taxable income is 8 percent.
- The provincial dividend tax credit is equal to 32 percent of the gross up on non-eligible dividends.
- All of the company's activities are confined to a province in which the applicable corporate rate of taxation is 4.5 percent on income eligible for the small business deduction. The province does not levy a payroll tax.

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

- A. Determine the after tax amount of cash that Waylon will retain if all of the company's cash is used to pay taxes and salary.
- B. Determine the after tax amount of cash that Waylon will retain if the Company pays the maximum possible dividend.
- C. Can Waylon 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 positive, determine the combination of salary and/or dividends that will produce the maximum after tax cash retention for Waylon. Calculate the amount of this after tax cash retention.
- E. Briefly describe any other factors that Waylon should consider in deciding whether to pay himself dividends or, alternatively, salary.

**TIF PROBLEM FIFTEEN - 16****Salary Vs. Dividend Decisions - Optimum Mix**

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Ms. Barbra Stickle is the only shareholder of Stickle Ltd., a Canadian controlled private corporation. The Company has a December 31 year end and, at December 31, 2016, Ms. Stickle determines that the Taxable Income of the Company for the year will be \$24,200. The Company has this amount available in cash, prior to the payment of taxes, dividends, or salary.

All of the Company's income qualifies as active business income and any dividends that it pays will be non-eligible. The Company's activities are confined to a province in which the applicable corporate rate of taxation is 3.5 percent on income eligible for the small business deduction. The province does not levy a payroll tax.

Ms. Stickle has no other source of income. In her tax bracket, the combined federal/provincial tax rate for individuals is 25 percent. For non-eligible dividends, the provincial dividend tax credit has been set at 30 percent of the dividend gross up. Ms. Stickle has combined personal tax credits for the 2016 taxation year in the amount of \$3,423.

**Required:**

- A. Determine the after tax amount of cash that Ms. Stickle will retain if all of the Company's income is paid to her in the form of salary. Ignore CPP contributions and the Canada employment tax credit.
- B. Determine the after tax amount of cash that Ms. Stickle will retain if the Company pays the maximum possible dividend.
- C. Can Ms. Stickle improve her after tax cash retention by using a combination of salary and dividends? Explain your conclusion.
- D. Determine the combination of salary and/or dividends that will produce the maximum after tax cash retention for Ms. Stickle. Calculate the amount of this after tax cash retention.
- E. Briefly describe any other factors that Ms. Stickle should consider in deciding whether to pay herself dividends or, alternatively, salary.

## **Chapter Sixteen Test Item File Problems**

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### **TIF PROBLEM SIXTEEN - 1**

#### **Rollovers Under Section 85 - Essay Questions**

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1. In the absence of ITA 85(1), tax considerations could make it difficult to incorporate an existing unincorporated business. Briefly explain the basis for this statement.
2. Identify the entities that can serve as transferors in a ITA 85 rollover.
3. Section 85 of the *Income Tax Act* allows the rollover of many types of assets to a corporation at elected values, a procedure that can avoid taxes being incurred at the time of the transfer. There are, however, certain categories of assets that are ineligible for this rollover provision. Indicate which categories of assets are ineligible for rollover under the provisions of Section 85. Briefly explain the reasons for these exclusions.
4. In making an election under ITA 85, it is important that all of the assets that are to be transferred are listed in the election form. Why is this the case?
5. When ITA 85(1) is being used, careful consideration must be given to the price that is elected for the transfer. Briefly explain the importance of this transfer value.
6. What is boot? What is its significance in the application of ITA 85(1)?
7. In deciding on the elected value to be used in an ITA 85 rollover, there are general rules that are applicable to all assets. Briefly describe these rules.
8. When a taxpayer transfers a business using the provisions of ITA 85, he is generally advised not to list accounts receivable among the assets that are included in the election. What is the basis for this advice?
9. When an individual transfers a non-depreciable capital asset to an affiliated person, any resulting capital loss is disallowed. Give three examples of affiliated persons.
10. Why does the *Income Tax Act* provide a special ordering rule for the transfer of depreciable assets under ITA 85?
11. When the transferor is a corporation, trust, or partnership, any loss on the transfer of eligible capital property is disallowed. How is this loss dealt with in the tax records of the transferor?
12. When assets are transferred to a corporation using ITA 85, the transferor can take back as consideration a combination of common shares, preferred shares, and non-share consideration. Briefly explain how the total adjusted cost base of the consideration received would be determined, and how it would be allocated to each type of consideration received by the transferor.
13. When a depreciable property is transferred to a corporation using the provisions of ITA 85, the elected value will usually be the UCC of the property. In these circumstances, the transferee is required to retain the original capital cost of the asset, with the difference between the capital cost and the UCC being treated as deemed CCA. What is the reason for this rule?
14. When a taxpayer is transferring depreciable assets under the provisions of ITA 85, he may elect a value that will result in a capital gain. If this is the case, how will the transferee's capital cost for CCA purposes be determined?

15. In general, when there has been a transfer of assets under ITA 85, a PUC reduction is required. Explain briefly how the amount of this PUC reduction is calculated.
16. In some applications of ITA 85, some amount of PUC may be left after the required PUC reduction. If more than one class of shares have been issued as part of the rollover, how is the remaining PUC allocated to the multiple classes of shares?
17. An individual wishes to transfer the assets of an unincorporated business to a corporation using ITA 85. He wishes to remove the maximum amount of cash from the corporation without incurring current taxation. In addition to cash, he will receive common shares in the new company. What values should he elect for the transfer of the assets? If he elects these values and removes the maximum amount of tax free cash, what will be the PUC and adjusted cost base of the common shares?
18. One of the most useful types of tax planning available to individuals with large amounts of income is income splitting. In implementing an income splitting arrangement, one of the most useful techniques is to have the individual transfer assets to a corporation under the provisions of Section 85 of the *Income Tax Act*. However, if such a transfer is not carefully designed, the full objectives of the income splitting plan may not be achieved. What steps must be taken to ensure that transfers of property under Section 85 do, in fact, achieve the desired income splitting goals?
19. Mr. Lawson, who is a resident of the United States, owns a number of rental properties in various cities throughout Canada. Having reached age 65, he would like to see these properties transferred to his children. However, he does not have sufficient cash to pay the taxes that would accrue if he simply gave the property to his children. He is somewhat aware of the provisions of Section 85 of the Canadian *Income Tax Act*, and is considering transferring the properties to a U.S. corporation in which his children would hold the residual equity shares. Advise Mr. Lawson as to the soundness of his plan.
20. A Section 85 rollover can result in a gift to a related person. Explain how this can arise. In addition, indicate the tax consequences to both the transferor and the individual who benefits from the gift.
21. A Section 85 rollover can result in an ITA 15(1) shareholder benefit to the transferor. Explain how this benefit can arise.
22. What is the objective of the legislation contained in ITA 84.1, the dividend stripping rules?
23. What is the objective of the legislation contained in ITA 55(2), the capital gains stripping rules?

## **TIF PROBLEM SIXTEEN - 2**

### **Rollovers Under Section 85 - True Or False**

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#### **New For 2016/2017**

1. ITA 85(1) can only be used to transfer an unincorporated business to a new corporation.  
True or False?
2. For purposes of ITA 85(1), eligible property includes real property owned by a non-resident person and used in the year in a business carried on by that person in Canada.  
True or False?
3. In an ITA 85(1) rollover, consideration for the transferor can only include debt and common shares.  
True or False?
4. In a Section 85(1) rollover, the elected value serves as proceeds of disposition for the property given up, the adjusted cost base of the property received from the corporation and the tax cost of the property received by the corporation.  
True or False?
5. In the context of ITA 85(1) rollovers, the term "boot" refers to any consideration received by the transferor other than common shares.  
True or False?
6. The elected value in a Section 85(1) rollover can never be above the fair market value of the non-share consideration.  
True or False?
7. For an individual, the only "affiliated person" is the individual's spouse or common-law partner.  
True or False?
8. In an ITA 85(1) rollover, the elected value cannot exceed 4/3 of the CEC balance.  
True or False?
9. When a depreciable asset is transferred in an ITA 85(1) rollover, the transferor may elect a value in excess of the capital cost of the asset. For the transferee corporation, the elected value will be the capital cost for CCA purposes.  
True or False?
10. In an ITA 85(1) rollover, any required PUC reduction will be allocated first to preferred shares issues, with any remaining balance allocated to common shares issued.  
True or False?

## **Retained From Previous Editions**

11. The taxpayer who is the transferor in an ITA 85(1) rollover must receive at least one share of the transferee corporation.

True or False?

12. The elected transfer price in an ITA 85(1) rollover can never be below the amount of non-share consideration received.

True or False?

13. In a Section 85 rollover, the lowest value that can be elected for the transfer of cumulative eligible capital is the greater of the fair market value of the boot and the least of 4/3 of the cumulative eligible capital balance, the cost of the individual eligible capital property, and the fair market value of the individual eligible capital property.

True or False?

14. If an asset is transferred in an ITA 85 rollover at an elected value that results in a capital gain to the transferor, the cost to the transferee for CCA purposes will be the transferor's cost, plus one-half of the excess of the elected value over the transferor's cost.

True or False?

## TIF PROBLEM SIXTEEN - 3

### Rollovers Under Section 85 - Multiple Choice

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#### New For 2016/2017

##### **General Rules For Transfer**

1. Which of the following assets **CANNOT** be transferred to a corporation under the provisions of ITA 85(1)?
  - A. Real property owned by a non-resident person and used in the year in a business carried on by that person in Canada.
  - B. Canadian Resource Property.
  - C. Eligible Capital Property.
  - D. Prepayments.
  
2. Which of the following would **NOT** be considered part of the boot received by a transferor in an ITA 85(1) rollover?
  - A. Bonds issued by the new corporation.
  - B. Redeemable preferred shares of the transferee.
  - C. The assumption of transferor debt by the transferee.
  - D. A non-interest bearing note issued by the new corporation.

##### **Transfer Prices - Detailed Rules**

3. Myron Cohen owns a retail store that he is currently operating as a proprietorship. In transferring the assets of this business to a corporation under the provisions of ITA 85(1), the elected value for the depreciable assets will be more than their UCC but less than their capital cost. This will result in:
  - A. A capital gain.
  - B. A terminal loss.
  - C. Recapture of CCA.
  - D. A capital loss and recapture of CCA.
  
4. Mary Battle transfers a depreciable capital property with a fair market value of \$100,000, a capital cost of \$85,000, and a UCC of \$47,500 to Battle Ltd. In consideration she receives cash of \$60,000 and shares with a fair market value of \$40,000, for a total value of \$100,000. Using the provisions of Section 85 for the transfer, she elects a value of \$90,000. Which of the following statements is correct?
  - A. Mary will have to report a capital gain of \$5,000 and no recapture of CCA.
  - B. Because she is using Section 85, she does not have to report any income.
  - C. Mary will have to report recapture of CCA of \$47,500.
  - D. Mary will have to report a capital gain of \$5,000 and recapture of CCA of \$37,500.

##### **Allocation Of The Elected Value**

5. Using the provisions of Section 85(1), Marion transferred a piece of land she held personally to a corporation in which she owned all of the shares. The adjusted cost base of the land was \$150,000 and it had a fair market value of \$225,000. In order to utilize a \$25,000 capital loss, she elected a value of \$175,000. What is the adjusted cost base of the land to the corporation?
  - A. \$175,000.
  - B. \$150,000.
  - C. \$225,000.
  - D. \$162,500

6. Under the provisions of ITA 85(1), Jason transferred a piece of land he held personally to a corporation in which he owned all of the shares. The adjusted cost base of the land was \$120,000 and, at the time of the transfer, it had a fair market value of \$390,000. The transfer took place at an elected value of \$120,000. As consideration, Jason received a promissory note for \$60,000, preferred shares with a fair market value of \$210,000, and common shares with a fair market value of \$120,000. Which one of the following is the adjusted cost base of the preferred shares (first) and the adjusted cost base of the common shares (second)?
- A. Nil and \$60,000.
  - B. \$60,000 and Nil.
  - C. \$38,181 and \$21,819.
  - D. \$210,000 and \$120,000.
7. Under the provisions of ITA 85(1), Marx Stanislawski transfers a depreciable asset to a corporation in which he is the only shareholder. The asset has a fair market value of \$500,000, a capital cost of \$320,000 and a UCC of \$180,000. Marx elects a transfer price of \$180,000. As consideration, he receives cash of \$140,000, and common shares with a legal stated capital of \$360,000. What is the required PUC reduction for the common shares?
- A. \$320,000.
  - B. \$220,000.
  - C. \$180,000.
  - D. \$40,000.

## Retained From Previous Editions

### *General Rules for the Transfer*

8. Which of the following statements fully describes a transferor or transferee under the provisions of ITA 85(1) and (2)?
- A. A transferee must be a corporation or trust.
  - B. A transferee must be a Canadian corporation.
  - C. A transferor must be an individual or a corporation.
  - D. Only individuals are permitted to be transferors under ITA 85(1).
9. There is only one requirement specified in ITA 85(1) with respect to the consideration that the corporation must give the transferor in exchange for property transferred to the corporation. What is it?
- A. The consideration given to the transferor must include shares of the corporation.
  - B. The consideration given to the transferor must include cash equal to the tax value of the property transferred to the corporation.
  - C. The consideration given to the transferor must include cash equal to the fair market value of the property transferred to the corporation.
  - D. The consideration given to the transferor can only include cash and shares of the corporation.

*Rollovers Under Section 85 - Multiple Choice*

10. Which of the following would be considered part of the boot received by a transferor in an ITA 85(1) rollover?
- A. Common shares of the transferee.
  - B. Redeemable preferred shares of the transferee.
  - C. Non-redeemable preferred shares of the transferee.
  - D. The assumption of transferor debt by the transferee.
11. Which of the following scenarios would be most appropriate for a Section 85 rollover?
- A. A shareholder of a corporation wishes to transfer property with a fair market value of \$150,000 and a tax cost of \$100,000 to his corporation.
  - B. A shareholder of a corporation wishes to transfer property with a fair market value of \$100,000 and a tax cost of \$150,000 to his corporation.
  - C. A shareholder of a corporation wishes to transfer property with a fair market value of \$150,000 and a tax cost of \$100,000 from his corporation.
  - D. A shareholder of a corporation wishes to transfer property with a fair market value of \$100,000 and a tax cost of \$150,000 from his corporation.

**Transfer Prices – Detailed Rules**

12. The general rules for transfer prices establish a range for the elected transfer price under ITA 85(1). Which of the following statements accurately describes the ceiling value?
- A. The fair market value of the share consideration given to the transferor.
  - B. The fair market value of the non-share consideration given to the transferor.
  - C. The fair market value of the assets transferred to the corporation.
  - D. The fair market value of the share and non-share consideration given to the transferor.
13. In transferring a business to a corporation, accounts receivable can be transferred using either ITA 22 or ITA 85(1), but not both. One advantage of using ITA 22 is:
- A. The vendor will be able to deduct a capital loss.
  - B. The acquiring corporation will be able to deduct a bad debts reserve after the transfer.
  - C. The vendor will not have to add back to income any previously deducted reserve.
  - D. The vendor will have a loss that may be considered superficial.
14. John Torros has an unlimited life franchise that cost \$150,000. His cumulative eligible capital balance is \$90,490 and the current fair market value of the franchise is \$225,000. Using the provisions of ITA 85(1), this asset is transferred to a corporation in return for cash of \$100,000 and common shares with a fair market value of \$125,000. Which of the following amounts is the minimum value that John could elect for the transfer?
- A. \$120,653.
  - B. \$150,000.
  - C. \$ 90,490.
  - D. \$100,000.

## Rollovers Under Section 85 - Multiple Choice

15. Eric Lehnerr owns 100 percent of Magnus Products Ltd. The shares were originally issued in 1982 for \$20,000. In 1986, they were acquired by Eric's father for \$25,000. In 2002, Eric's father died and left the shares to Eric. At that time, they were deemed to have been disposed of for \$100,000. On the terminal return for Eric's father, a capital gain of \$75,000 was reported, and tax was paid on the taxable capital gain of \$37,500. Eric wishes to transfer the shares, now valued at \$250,000, to a holding corporation owned by himself, electing under Section 85(1) of the *Income Tax Act*. Magnus Products Ltd. has never paid dividends of any kind.

Which one of the following amounts represents the minimum possible elected amount under Section 85(1), ignoring the impact of consideration received?

- A. \$20,000.  
B. \$25,000.  
C. \$100,000.  
D. \$250,000.
16. Noor Ali transfers shares in Ali Manufacturing Inc. to Ali Holdings Ltd., a corporation which she controls. The shares have an adjusted cost base of \$35,000 and a fair market value of \$5,000. Noor elects to transfer these shares under Section 85 at an elected value of \$5,000. The \$30,000 capital loss on this transfer:
- A. Will be disallowed and kept in the tax records of the transferor to be recognized when the corporation is subject to an acquisition of control or is wound up.  
B. Will be disallowed and allocated to the ACB of the shares in the tax records of Ali Holdings Ltd.  
C. Will be deductible to the transferor as the transferor is an individual.  
D. Will be deductible to the transferee as the transferor is an individual.
17. Ali Manufacturing Inc. owns shares in Ali Holdings Inc, which it will transfer to Family Holdings Ltd. using Section 85. The shares have an adjusted cost base of \$35,000 and a fair market value of \$5,000, and an elected transfer price of \$5,000 is used. The \$30,000 capital loss on this transfer:
- A. Will be disallowed and kept in the tax records of the transferor to be recognized when the corporation is subject to an acquisition of control or is wound up.  
B. Will be disallowed with no opportunity to deduct the loss in the future.  
C. Will be allocated to the ACB of the shares in the tax records of Family Holdings Ltd., as the transferor is a corporation.  
D. Will be carried forward as a net capital loss in the records of Family Holdings Ltd., and will be deductible in a future year against any capital gains that are earned by that corporation.
18. Mayumi Tajima transfers a depreciable asset to a CCPC in which she is the only shareholder. The asset has a cost of \$100,000 and a UCC of \$64,000. Mayumi will elect a transfer price equal to the fair market value of the asset which is \$150,000. This transfer will result in:
- A. A taxable capital gain of \$43,000 with the capital cost of the asset to the transferee being \$150,000.  
B. A taxable capital gain of \$25,000, recapture of \$36,000 and the capital cost of the asset to the transferee will be \$100,000.  
C. A taxable capital gain of \$25,000, recapture of \$36,000 and the capital cost of the asset to the transferee will be \$150,000.  
D. A taxable capital gain of \$25,000, recapture of \$36,000 and the capital cost of the asset to the transferee will be \$125,000.

19. Meng Zheng wishes to transfer a piece of machinery to a corporation using ITA 85(1). This machinery is currently used to produce income. It has a capital cost of \$250,000, a UCC balance of \$58,000 and a fair market value of \$50,000. Which of the following statements is correct?
- A. Section 85(1) does not apply. The terminal loss will be denied permanently if the property is transferred to the corporation.
  - B. This proposed transfer can be completed using ITA 85(1). As an alternative, the property could be transferred to the corporation by selling it at fair market value, in which case the terminal loss will be deductible in the year of transfer.
  - C. Section 85(1) does not apply. The terminal loss will be denied until the property is eventually disposed of to a non-affiliated person or the use of the property is changed to a non-income earning use.
  - D. This proposed transfer can be completed using ITA 85(1). The terminal loss will be deductible to the transferor as long as the corporation continues to use the machinery to produce income.
20. Bridget transferred a piece of land she held personally to her wholly owned corporation using the provisions of ITA 85. The land had an adjusted cost base of \$150,000 and a fair market value of \$250,000 at the time of transfer. The property was mortgaged for \$50,000. As consideration for the transfer, Bridget received cash of \$200,000 and preferred shares with a legal stated capital of \$10,000. The corporation assumed the mortgage. Which one of the following is the elected transfer price (first) and the adjusted cost base of the preferred shares (second)?
- A. \$250,000 and Nil
  - B. \$250,000 and \$240,000
  - C. \$260,000 and \$50,000
  - D. \$150,000 and Nil

#### **Allocation Of The Elected Value**

21. Harold Warren incorporated Warren Enterprises Ltd. at the beginning of the current year. In addition to a \$100,000 cash contribution, Harold contributed assets with a total tax value of \$100,000 and a total fair market value of \$150,000. In return, he receives 25,000 voting shares in the new corporation. If he elects a value that will result in minimum current Tax Payable, the adjusted cost base of the voting shares will be:
- A. \$100,000.
  - B. \$150,000.
  - C. \$200,000.
  - D. \$250,000.
22. Barry Hicks owns a building with a capital cost of \$200,000, a UCC balance of \$150,000, and a fair market value of \$600,000. This property is transferred to a corporation under the provisions of ITA 85(1). The corporation assumes the \$50,000 mortgage on the building. In return for the building, Barry receives a promissory note for \$40,000 and preferred shares with a fair market value of \$510,000. If Barry elects a value that will maximize tax deferral, the adjusted cost base of the preferred shares is:
- A. Nil.
  - B. \$60,000.
  - C. \$110,000.
  - D. \$600,000.

*Rollovers Under Section 85 - Multiple Choice*

23. Mr. Santaguida wishes to transfer his proprietorship to a corporation. He has no eligible capital property on the balance sheet of the proprietorship, but you are recommending that he transfer goodwill at an elected value of \$1. Why?
- It is a requirement of ITA 85(1) to transfer goodwill at an elected value of \$1 in every rollover that is completed.
  - The general rules for transfer price elections for eligible capital property set the minimum transfer price for assets such as goodwill at a value of \$1.
  - The amount of \$1 is the fair market value of the goodwill since it is not carried on the balance sheet.
  - To ensure the goodwill is included in the election, and also ensure that the transfer of goodwill is not considered a gift.
24. Daniel Kwok transfers his business assets to a corporation and elects a value of \$678,000 for the assets transferred. These assets have a fair market value of \$1,250,000. Daniel receives the following consideration:
- |  |           |
|--|-----------|
| Cash   | \$150,000 |
| Preferred shares of the new corporation with a fair market value | 500,000   |
| Common shares of the new corporation with a fair market value    | 600,000   |
- How will the elected value be allocated between: the non-share consideration, the preferred shares issued, and the common stock issued.
- \$150,000; \$0; \$528,000
  - \$150,000; \$500,000; \$28,000
  - \$150,000; \$528,000; \$0
  - \$150,000; \$264,000; \$264,000
25. Jason transferred a piece of land he held personally to a corporation in which he owned all of the shares using the provisions of ITA 85. The adjusted cost base of the land was \$60,000 and it had a fair market value of \$120,000 at the time of the transfer. In order to utilize a capital loss, Jason elected a transfer price of \$105,000. What is the adjusted cost base of the land to the corporation?
- \$60,000
  - \$82,500
  - \$105,000
  - \$120,000

***Paid Up Capital of Shares Issued***

26. Mary Hanson is holding 1,000 shares of Hanson Operations. They have an adjusted cost base and Paid Up Capital of \$20,000. Their current fair market value is equal to \$200,000. Electing under ITA 85 in a manner that will maximize tax deferral, the shares are transferred to Hanson Holdings Inc., in return for \$8,000 in cash and 250 Hanson Holdings shares with a fair market value of \$192,000. The Paid Up Capital of the Hanson Holdings shares will be:
- \$12,000.
  - \$20,000.
  - \$192,000.
  - \$200,000.

**Gift to Related Person – Section 85**

27. Mr. Fingula transfers property to a corporation owned by his daughter. In which of the following situations do the indirect gift rules apply?
- A. The property is transferred to the corporation at an elected amount that is equal to the fair market value of the asset and the consideration.
  - B. The property has a fair market value that exceeds the greater of the fair market value of the consideration received and the elected value.
  - C. The property has a fair market value that is less than the greater of the fair market value of the consideration received and the elected value.
  - D. The property is transferred to the corporation at an elected amount that is less than the fair market value and Mr. Fingula receives consideration equal to the fair market value.
28. Ms. Bimo transfers a non-depreciable capital property to a corporation in which all of the common shares are owned by her son. The property has a fair market value of \$150,000 and an adjusted cost base of \$35,000. Ms. Bimo transfers the property using an elected amount of \$35,000 and the corporation issues her a note payable in the amount of \$35,000 and preferred shares with a fair market value of \$100,000. The ITA 85(1)(e.2) excess amount (i.e. indirect gift) is:
- A. \$15,000
  - B. \$115,000
  - C. \$100,000
  - D. \$35,000
29. Bruno owns 75 percent of the common shares of a corporation. His adult daughter owns the remaining 25 percent. During the current year, Bruno transferred shares from his investment portfolio that had an adjusted cost base of \$55,000 to the corporation. These shares had a fair market value of \$85,000 at the time of transfer and Bruno elected to transfer them at \$55,000 under the provisions of ITA 85. As consideration for the transfer, he received a promissory note for \$55,000 and preferred shares with a fair market value of \$20,000. Which one of the following is the elected transfer price (first) and the adjusted cost base of the preferred shares (second)?
- A. \$55,000 and \$20,000
  - B. \$55,000 and \$30,000
  - C. \$65,000 and \$20,000
  - D. \$65,000 and Nil

**Section 85 – Excess Consideration**

30. The use of ITA 85(1) to transfer property to a corporation would result in a benefit to a shareholder under ITA 15(1) in a situation where:
- A. The fair market value of the property transferred is less than the consideration received.
  - B. A capital gain is triggered on the transfer resulting in taxable income to the transferor.
  - C. The elected value is received entirely in the form of non-share consideration.
  - D. The fair market value of the property transferred is greater than the consideration received.

*Rollovers Under Section 85 - Multiple Choice*

31. Mr. Patel transfers land with an adjusted cost base of \$75,000 and a fair market value of \$200,000 to a new CCPC in which he is the sole shareholder. He takes back consideration which includes debt with a fair market value of \$140,000 and redeemable preferred shares with a fair market value and legal stated capital of \$160,000. The elected transfer price is \$200,000. The immediate increase in Mr. Patel's income would be:
- \$0
  - \$100,000
  - \$112,500
  - \$162,500

**Dividend Stripping**

32. Which of the following conditions is **NOT** required for ITA 84.1 (dividend stripping rules) to be applicable?
- The shares that are disposed of must have been held as capital property.
  - The subject corporation must be associated with the purchaser corporation after the disposition of the shares.
  - The share disposition must be made to a corporation with which the taxpayer does not deal at arm's length.
  - The taxpayer who disposes of the shares must be a Canadian resident.
33. Jean Hill, a Canadian resident, transfers 100 percent of the shares in Hill Inc. to a new company, Jean Ltd. The Hill Inc. shares have an adjusted cost base and PUC of \$100,000, and a fair market value of \$1,000,000. The transfer is made under the provisions of ITA 85 at an elected value of \$850,000. Ms. Hill receives cash of \$850,000 and retractable preferred shares with a fair market value of \$150,000. What are the immediate tax consequences to Ms. Hill, resulting from this transfer?
- A capital gain of \$900,000.
  - An ITA 84.1(1) deemed dividend of \$750,000 and no capital gain.
  - An ITA 84.1(1) deemed dividend of \$750,000, plus a capital gain of \$150,000.
  - A capital gain of \$750,000.

**Capital Gains Stripping**

34. Which of the following conditions is **NOT** required for ITA 55(2) (capital gains stripping rules) to apply?
- There is a disposition of shares by a corporation to an arm's length party.
  - The corporation that has disposed of the shares has received dividends that are deductible under ITA 112(1).
  - One of the purposes of the dividend received by the corporation was to significantly reduce a capital gain on the disposition of shares.
  - The corporation selling the shares must be a private company.
35. Parent Co. owns 100 percent of the shares of Son Co. They have a fair market value of \$950,000, and an adjusted cost base of \$75,000. Son Co. has safe income of \$60,000. In order to complete a sale of Son Co. to Unrelated Co., an arm's length corporation, Son Co. borrows \$875,000 from a bank, and uses the funds to pay a dividend to Parent Co. As a result, the fair market value of the Son Co. shares drops to \$75,000. At this point, the shares are sold to Unrelated Co. for \$75,000. Under these circumstances, the tax consequences for Parent Co. are:
- A taxable capital gain of \$437,500 and no dividends.
  - Dividend income of \$875,000 and no capital gains.
  - A taxable capital gain of \$437,500 and a dividend of \$875,000.
  - A taxable capital gain of \$407,500 and a dividend of \$60,000.

## **TIF PROBLEM SIXTEEN - 4**

### **Rollovers Under Section 85 - Exam Exercises**

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***Exam Exercise Subject Listing For Chapter 16***

<b>Number</b>	<b>Subject</b>
1	Elected Value For Non-Depreciable Property
2	Elected Value For Non-Depreciable Property
3	Elected Value For Depreciable Property
4	Elected Value For Depreciable Property
5	Elected Value For CEC
6	Elected Value For CEC
7	ACB Of Consideration Received
8	ACB Of Consideration Received
9	PUC Reduction - Section 85
10	PUC Reduction - Section 85
11	Section 85 Rollover
12	Section 85 Rollover
13	Gift To Related Party - Section 85
14	Gift To Related Party - Section 85
15	Excess Consideration - Section 85
16	Excess Consideration - Section 85
17	Dividend Stripping
18	Capital Gains Stripping

**Exam Exercise Sixteen - 1 (Elected Value For Non-Depreciable Property)**

Natasha Pulski's unincorporated business has inventories with a fair market value of \$47,000 and a tax cost of \$55,000. In addition, it has land with a fair market value of \$275,000 and a tax cost of \$83,000. She intends to transfer these assets to a new corporation, taking back \$47,000 in cash for the inventories and \$122,000 in cash for the land. If she uses Section 85(1) for the transfer, what is the possible range of values that can be elected for the two properties? If, in each case, she elects the lowest possible value, what are the tax consequences for Ms. Pulski?

**Exam Exercise Sixteen - 2 (Elected Value For Non-Depreciable Property)**

Natalie Bushkin's unincorporated business has land with a fair market value of \$322,000 and an adjusted cost base of \$147,000. In addition, the business has inventories with a fair market value of \$23,000 and a tax cost of \$25,000. She intends to transfer these assets to a new corporation, taking back \$160,000 in cash for the land and \$23,000 in cash for the inventories. If she uses Section 85(1) for the transfer, what is the possible range of values that can be elected for the two properties? If, in each case, she elects the lowest possible value, what are the tax consequences for Natalie?

**Exam Exercise Sixteen - 3 (Elected Value For Depreciable Property)**

Ms. Helen Nasser has two depreciable assets - a Class 1 building and a Class 8 piece of equipment. The assets are to be transferred to a corporation using ITA 85. Relevant information on the assets is as follows:

	Class 1	Class 8
Fair Market Value Of The Property	\$390,000	\$15,000
UCC Of Class (Last Asset In Class)	134,000	10,000
Cost Of The Property	191,000	27,000
Fair Market Value Of The Boot	246,000	11,000

What is the possible range of values that can be elected for the two properties? If, in each case, she elects the lowest possible value, what are the tax consequences for Ms. Nasser?

**Exam Exercise Sixteen - 4 (Elected Value For Depreciable Property)**

Joan Barkin is going to transfer the depreciable assets of her unincorporated business to a corporation in which she will be the sole shareholder. Relevant information on the assets is as follows:

	Class 1	Class 8
Fair Market Value Of The Property	\$263,000	\$46,000
UCC Of Class (Last Asset In Class)	122,000	52,000
Cost Of The Property	201,000	81,000
Fair Market Value Of The Boot	100,000	46,000

Joan would like to defer as much current taxation as possible. At what value should she transfer each of the assets? Justify your conclusions. If she elects that value, what are the tax consequences for Joan in each case?

**Exam Exercise Sixteen - 5 (Elected Value For CEC)**

During 2014, Trang Ventures acquires an unlimited life franchise at a cost of \$121,000. Maximum CEC is deducted for that year. At the beginning of 2015, all of the assets of Trang Ventures are transferred to a new corporation using the provisions of ITA 85. At this time, the fair market value of the franchise is estimated to be \$168,000. Trang's consideration for this asset is made up of \$121,000 in cash, plus shares in the new corporation with a fair market value of \$47,000. What is the possible range of values that can be elected for the franchise? If the minimum value is elected, what would be the tax consequences for Trang Ventures?

**Exam Exercise Sixteen - 6 (Elected Value For CEC)**

In the taxation year ending December 31, 2013, Jake's Enterprises acquires an unlimited life franchise at a cost of \$200,000. Maximum CEC is deducted in both 2013 and 2014. In 2015, this franchise is transferred to a new corporation using the provisions of ITA 85. At the time of transfer, the fair market value of the franchise is estimated to be \$220,000. In return for this franchise, Jake's Enterprises receives \$200,000 in cash and shares with a fair market value of \$20,000. What is the possible range of values that can be elected for the franchise? If the minimum value is elected, what would be the tax consequences for Jake's Enterprises?

**Exam Exercise Sixteen - 7 (ACB Of Consideration Received)**

Using ITA 85, Tom Leung transfers non-depreciable capital property to a corporation at an elected value of \$86,800. The property has an adjusted cost base of \$86,800 and a fair market value of \$246,400. As consideration, he receives a note for \$71,400, preferred shares with a fair market value of \$74,200, and common shares with a fair market value of \$100,800. Indicate the adjusted cost base of the individual items of consideration received by Mr. Leung.

**Exam Exercise Sixteen - 8 (ACB Of Consideration Received)**

Karl Young owns a non-depreciable capital asset with an adjusted cost base of \$220,000 and a fair market value of \$460,000. He intends to transfer the property to a corporation under the provisions of ITA 85, using an elected value of \$220,000. As consideration he will receive a note for \$110,000, preferred shares with a fair market value of \$90,000, and common shares with a fair market value of \$260,000. Indicate the adjusted cost base of the individual items of consideration received by Karl.

**Exam Exercise Sixteen - 9 (PUC Reduction - Section 85)**

Using ITA 85, Ms. Robyn Tunney transfers non-depreciable capital property to a corporation at an elected value of \$91,200. The property has an adjusted cost base of \$91,200 and a fair market value of \$187,200. As consideration, she receives a note for \$66,400, preferred shares with a fair market value and legal stated capital of \$77,600, and common shares with a fair market value and legal stated capital of \$43,200. Indicate the adjusted cost base and the PUC of the preferred and common shares that were issued to Ms. Tunney.

**Exam Exercise Sixteen - 10 (PUC Reduction - Section 85)**

Christine Rue transfers a non-depreciable capital property to a corporation, using the provisions of ITA 85. The property has a fair market value of \$342,000 and an adjusted cost base of \$111,000. She uses an elected value of \$111,000. As consideration she receives:

- Cash of \$21,000.
- Preferred shares with a fair market value of \$50,000.
- Common shares with a fair market value of \$271,000.

Indicate the adjusted cost base and the PUC of the preferred and common shares that were issued to Christine.

**Exam Exercise Sixteen - 11 (Transfers Under Section 85 - Tax Consequences)**

Jack Wild owns a depreciable property with a capital cost of \$120,000 and a fair market value of \$180,000. It is the only asset in its CCA class and the UCC balance for the class is \$98,000. He uses ITA 85 to transfer this property to a new corporation at an elected value of \$160,000. In return for the property, he receives a note for \$160,000, in addition to common shares with a fair market value of \$20,000.

What are the tax implications of this transaction for both Jack Wild and the transferee corporation? Include in your answer the adjusted cost base and PUC of the shares.

**Exam Exercise Sixteen - 12 (Transfers Under Section 85 - Tax Consequences)**

Darlene Saunders has operated an unincorporated business for over 10 years. The business has been very successful and has now reached a point where it is producing more income than she requires for her personal needs. Given this, she would like to transfer the business to a new corporation, using the provisions of ITA 85(1).

At the transfer date, the tangible assets of the business have tax values of \$375,000. Their fair market value is \$1,190,000. In addition, because of the success of the business, it is estimated that the business has goodwill of \$320,000. At the transaction date, liabilities total \$115,000.

The elected value for the transfer will be equal to the tax values of \$375,000. The corporation will assume the \$115,000 in liabilities that are on the books of the business. In addition, Darlene will receive:

- New debt of \$85,000.
- Preferred shares with a fair market value of \$100,000.
- Common shares with a fair market value of \$1,210,000.

Any dividends paid by the corporation will be non-eligible.

**Required:** Determine the following:

1. The adjusted cost base of each type of consideration received by Darlene.
2. The paid up capital of each type of share issued by the new corporation.
3. The tax consequences to Darlene of the new preferred shares being redeemed at their fair market value immediately.

**Exam Exercise Sixteen - 13 (Gift To Related Party - Section 85)**

Samuel Rosen establishes a new corporation, arranging to have all of its common shares issued to his adult daughter for cash of \$500. Mr. Rosen then transfers, using ITA 85, non-depreciable capital property with an adjusted cost base of \$67,500 and an estimated fair market value of \$87,750. The transfer is made at an elected value of \$67,500. As consideration for this property, the corporation gives Mr. Rosen a note for \$67,500 and preferred stock with a fair market value and a legal stated capital of \$20,250. A CRA reassessment of this transaction determines that the actual fair market value of the property transferred is \$100,000. Mr. Rosen reluctantly accepts this value.

After the reassessment, Mr. Rosen and his daughter sell their shares for their fair market value.

Describe the tax consequences of these transactions for both Mr. Rosen and his daughter. How would these tax consequences differ if Mr. Rosen had simply sold the non-depreciable capital property for its post-reassessment fair market value of \$100,000?

**Exam Exercise Sixteen - 14 (Gift To Related Party - Section 85)**

Derek Blunt wishes to transfer a non-depreciable capital property to a corporation that is owned by his adult daughter. The corporation is a new corporation, established with an investment of \$100 in cash. Derek's daughter holds all of the common shares in this new corporation.

At the time of its transfer to the corporation, the non-depreciable capital property has an adjusted cost base of \$250,000 and an estimated fair market value of \$400,000. The transfer is made at an elected value of \$250,000, with Derek receiving the corporation's note for \$250,000, as well as preferred shares with a legal stated capital and fair market value of \$150,000. A CRA reassessment of this transaction determines that the actual fair market value of the property transferred is \$475,000. Mr. Blunt reluctantly accepts this value.

After the reassessment, Derek and his daughter both sell their shares in the new corporation for their fair market value.

Describe the tax consequences of these transactions for both Mr. Blunt and his daughter. How would these tax consequences differ if Mr. Blunt had simply sold the non-depreciable capital property for its post-reassessment fair market value of \$475,000?

**Exam Exercise Sixteen - 15 (Excess Consideration - Section 85)**

Mrs. Jeanne Keanings uses ITA 85 to transfer non-depreciable property to a CCPC in which she owns 100 percent of the shares. The adjusted cost base of the property is \$136,000 and it has a fair market value of \$224,000. In consideration for this property, Mrs. Keanings receives a note for \$193,000 and preferred stock with a fair market value and a legal stated capital of \$90,000. Mrs. Keanings elects to make the transfer at the fair market value of \$224,000. Any dividends paid by the corporation will be non-eligible.

What are the tax consequences of this transaction to Mrs. Keanings? Include in your answer the effect of the transfer on Mrs. Keanings' Net Income For Tax Purposes and the ACB and PUC of the preferred shares.

**Exam Exercise Sixteen - 16 (Excess Consideration - Section 85)**

Using the provisions of ITA 85, Martha Stuart transfers a non-depreciable capital property to a CCPC in which she owns 100 percent of the shares. The adjusted cost base of the property is \$270,000 and it has a fair market value of \$415,000. In return for this property, Ms. Stuart receives a note for \$380,000 and preferred shares with a legal stated capital and fair market value of \$170,000. The elected value for the transfer is the fair market value of \$415,000. Any dividends paid by the corporation will be non-eligible.

What are the tax consequences of this transaction to Ms. Stuart? Include in your answer the effect of the transfer on Ms. Stuart's Net Income For Tax Purposes, as well as the ACB and PUC of the preferred shares.

**Exam Exercise Sixteen - 17 (Dividend Stripping)**

Mr. Marshal Stack owns 100 percent of the outstanding shares of Stack Ltd., a qualified small business corporation. The shares have a PUC and an adjusted cost base of \$132,000 and a fair market value of \$699,000. The Company has no balance in its GRIP account. Mr. Stack uses ITA 85(1) to transfer these shares to Stack's Investments Ltd., at an elected value of \$699,000. As consideration, he receives a note for \$390,000 and preferred shares with a fair market value and a legal stated capital of \$309,000. Mr. Stack owns all of the shares of Stack's Investments Ltd. and has made no use of his lifetime capital gains deduction.

What are the tax consequences of this transaction to Mr. Stack? Include in your answer the adjusted cost base and the PUC of the new preferred shares.

**Exam Exercise Sixteen - 18 (Capital Gains Stripping)**

Foral Inc., a Canadian public company, owns 80 percent of the outstanding shares of Matlin Ltd. Matlin Ltd. is also a Canadian public company. The shares of Matlin Ltd. have an adjusted cost base of \$125,000 and a fair market value of \$940,000. Included in the Retained Earnings balance of Matlin Ltd. is \$285,000 of income that has been earned since its acquisition by Foral.

Foral Inc. wishes to dispose of these shares, and Sored Company is interested in acquiring them. In order to accomplish this goal, the Matlin Ltd. shares are transferred to Sored, under the provisions of Section 85, at an elected value of \$125,000. As consideration for the transferred shares, Foral Inc. receives redeemable preferred shares issued by the Sored Company. These shares have a fair market value of \$940,000. Their adjusted cost base and PUC are equal to the elected value of \$125,000. Foral Inc. redeems these shares immediately. Describe the tax consequences to Foral Inc. of the redemption.

**TIF PROBLEM SIXTEEN - 5A****Rollovers Under Section 85 - Key Term Matching (Easy)**

**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 16, "Rollovers Under Section 85".

- A. Boot
- B. Capital Gains Stripping
- C. Subject Corporation
- D. Dividend Stripping
- E. Non-Share Consideration
- F. Rollover
- G. Superficial Loss - ITA 54
- H. Transferee

The following list contains ten potential definitions for the preceding key terms.

1. Consideration received by a taxpayer from a corporation that is in the form of assets other than shares of the corporation.
2. Procedures designed to allow an individual to remove accumulated income from a corporation in the form of tax-free capital gains, while still retaining control of the corporation.
3. A taxpayer who makes a transfer.
4. A deduction in the calculation of business and property income which arises when the last asset in a CCA Class is retired and a positive balance is left in the Class.
5. A loss on the disposition of property that is disallowed for tax purposes because the taxpayer has acquired an identical property, either 30 days before the disposition or, alternatively, 30 days after the disposition.
6. Procedures designed to allow a corporation to convert a taxable capital gain resulting from the disposition of investment shares to an arm's length party, into a tax free intercorporate dividend.
7. For purposes of the Part IV tax, a public corporation that is controlled by, or for the benefit of, an individual or a related group of individuals.
8. A tax free transfer of assets under circumstances that, in the absence of a special provision, would be considered a taxable transfer.
9. A taxpayer to whom a transfer is made.
10. A colloquial term used by tax practitioners to refer to non-share consideration.
11. None of the above definitions apply. (This answer can be used more than once.)

*Rollovers Under Section 85 - Key Term Matching (Easy)*

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM SIXTEEN - 5B****Rollovers Under Section 85 - Key Term Matching  
(Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 16, “Rollovers Under Section 85”.

- A. Boot
- B. Capital Gains Stripping
- C. Subject Corporation
- D. Dividend Stripping
- E. Non-Share Consideration
- F. Rollover
- G. Superficial Loss - ITA 54
- H. Transferee

The following list contains ten potential definitions for the preceding key terms.

1. Consideration received by a taxpayer from a corporation that is in the form of assets other than shares of the corporation.
2. A colloquial term used by tax practitioners to refer to cash consideration.
3. Procedures designed to allow an individual to remove accumulated income from a corporation in the form of tax-free capital gains, while still retaining control of the corporation.
4. A taxpayer who makes a transfer.
5. As this term is used in tax work, it refers to any tax free transfer of assets between related persons.
6. A deduction in the calculation of business and property income which arises when the last asset in a CCA Class is retired and a positive balance is left in the Class.
7. A loss on the disposition of property that is disallowed for tax purposes because the taxpayer has acquired an identical property, either 30 days before the disposition or, alternatively, 30 days after the disposition.
8. Procedures designed to allow a corporation to convert a taxable capital gain resulting from the disposition of investment shares to an arm’s length party, into a tax free intercorporate dividend.
9. Consideration received by a taxpayer from a corporation that is in the form of cash or a note payable.
10. For purposes of the Part IV tax, a public corporation that is controlled by, or for the benefit of, an individual or a related group of individuals.

*Rollovers Under Section 85 - Key Term Matching (Moderate)*

11. A tax free transfer of assets under circumstances that, in the absence of a special provision, would be considered a taxable transfer.
12. A taxpayer to whom a transfer is made.
13. A colloquial term used by tax practitioners to refer to non-share consideration.
14. Procedures designed to allow a corporation to convert a taxable capital gain resulting from the disposition of investment shares to a non-arm's length party, into a tax free intercorporate dividend.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM SIXTEEN - 6****Transfer To A Corporation Vs. Direct Sale**

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Several years ago, Ms. Fox acquired a small apartment building for total consideration of \$950,000. This total was allocated on the basis of \$225,000 for the land and \$725,000 for the building.

At present, the property has a fair market value of \$1,200,000, with \$300,000 of this total attributable to the land. Ms. Fox would like to transfer the property to a corporation using a Section 85 rollover. At the beginning of the current year, the building had a UCC of \$582,000. The value elected for the transfer is \$807,000 (\$225,000 + \$582,000). The consideration given to Ms. Fox for the property is 12,000 common shares.

Shortly after the Section 85 rollover is completed, Ms. Fox sells all of the common shares she received as a result of the transfer to Mr. Hound, an arm's length party, for proceeds of \$1,200,000.

**Required:**

- A. Describe the tax consequences for Ms. Fox of using Section 85 and selling the common shares.
- B. How do these results compare with the tax consequences of simply selling the building directly to Mr. Hound for \$1,200,000?

## **TIF PROBLEM SIXTEEN - 7**

### **ACB Of Consideration And PUC**

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Jeremy Steel intends to transfer a tract of land to a new corporation. The land has an adjusted cost base of \$225,000 and a fair market value of \$625,000. The transfer will be implemented under the provisions of ITA 85 at an elected value of \$225,000.

Mr. Steel is considering the following alternative consideration packages:

	<b>Alternative</b>		
	<b>One</b>	<b>Two</b>	<b>Three</b>
Debt Of The New Corporation	\$150,000	\$175,000	\$210,000
Preferred Shares	50,000	450,000	Nil
Common Shares	425,000	Nil	415,000
<b>Total</b>	<b>\$625,000</b>	<b>\$625,000</b>	<b>\$625,000</b>

All of the amounts in the preceding table are fair market values.

**Required:**

- A. For each of the three alternatives, determine the adjusted cost base of the individual items of consideration received by Mr. Steel.
- B. For each of the three alternatives, determine the legal stated capital and the Paid Up Capital for the preferred and/or common shares issued.

## **TIF PROBLEM SIXTEEN - 8**

### **ACB Of Consideration And PUC**

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Janice Tabor has a depreciable property that she wishes to transfer to a new corporation under the provisions of Section 85(1). The property has a capital cost of \$450,000, a UCC of \$225,000, and a fair market value of \$675,000. The transfer will take place at an elected value of \$400,000.

Ms. Tabor is considering the following alternative consideration packages:

	<b>Alternative</b>		
	<b>One</b>	<b>Two</b>	<b>Three</b>
Debt Of The New Corporation	\$150,000	\$375,000	\$300,000
Preferred Shares	150,000	300,000	Nil
Common Shares	375,000	Nil	375,000
<b>Total</b>	<b>\$675,000</b>	<b>\$675,000</b>	<b>\$675,000</b>

All of the amounts in the preceding table are fair market values.

**Required:**

- A. For each of the three alternatives, determine the adjusted cost base of the individual items of consideration received by Ms. Tabor.
- B. For each of the three alternatives, determine the legal stated capital and the Paid Up Capital for the preferred and/or common shares issued.

**TIF PROBLEM SIXTEEN - 9****Depreciable Asset Transfer - Three Cases**

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Paul Kwan owns a rental property that he acquired some years ago for \$780,000. Of this total, \$280,000 was allocated to the land and \$500,000 was allocated to the building.

An appraiser has estimated that the current fair market value of the land is \$425,000 and the current fair market value of the building is \$775,000. The current UCC of the building is \$391,000.

Mr. Kwan wishes to use ITA 85 to transfer this property to a new corporation, Kwan Ltd. in which he is the sole shareholder.

**Case A** Mr. Kwan elects to transfer the property at an elected value of \$280,000 for the land and \$391,000 for the building. In return, he receives shares in the new corporation with a fair market value and legal stated capital of \$1,200,000 (\$425,000 + \$775,000).

**Case B** Mr. Kwan elects to transfer the property at an elected value of \$425,000 for the land and \$391,000 for the building. The consideration consists of shares in the new corporation with a fair market value and legal stated capital of \$1,200,000.

**Case C** Mr. Kwan elects to transfer the property at an elected value of \$425,000 for the land and \$391,000 for the building. The consideration consists of a promissory note from the corporation for \$816,000, along with shares in the new corporation with a fair market value and legal stated capital of \$384,000.

**Required:** For each of the preceding independent cases, determine:

- The immediate tax consequences of the transfer.
- The tax costs of the land and building in the hands of the corporation.
- The adjusted cost base of the shares issued by the corporation.
- The PUC of the shares issued by the corporation.

**TIF PROBLEM SIXTEEN - 10****Transfers To A Corporation - Depreciable Property**

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During December, 2016, Mr. Norris Notion transferred a depreciable capital property to a new corporation. The property is the only asset in its CCA class, and Mr. Notion will own all of the shares of the new corporation. The CCA class had a UCC of \$52,000. The property had an original cost of \$58,000 and a fair market value of \$92,000. As Mr. Notion had a capital loss of \$20,000 during 2016, he elected to transfer the property, under the provisions of ITA 85(1), at a value of \$78,000. As consideration for the property, Mr. Notion takes back a note for \$68,000, preferred shares with a fair market value of \$20,000, and common shares with a fair market value of \$4,000.

**Required:** Describe the income tax implications resulting from this transaction. Your answer should include both current tax implications, and the determination of values that will have future tax implications.

**TIF PROBLEM SIXTEEN - 11****Transfers To A Corporation And Sale/Redemption Of Shares**

Several years ago, Ms. Katrina Bond acquired a business location that included land and a building for a total of \$950,000. At the time, it was estimated that the value of the land was \$220,000 and the value of the building was \$730,000.

Ms. Bond operated the business for several years as a sole proprietorship and, during this period, she took CCA on the building. As there were years in which she experienced losses, she did not always take the maximum amount of CCA.

Ms. Bond has finally agreed to take your advice and incorporate the business. She will use ITA 85(1) to transfer the land and building to the new corporation in January, 2016. At the time of the transfer, the building had a UCC of \$625,000. Other relevant values were as follows:

<b>Asset</b>	<b>Tax Cost</b>	<b>Appraised Value</b>	<b>Elected Amount</b>
Land	\$220,000	\$ 510,000	\$220,000
Building	625,000	980,000	730,000
<b>Total</b>	<b>\$845,000</b>	<b>\$1,490,000</b>	<b>\$950,000</b>

There is a \$400,000 mortgage on the land and building that will be assumed by the new corporation. In addition, the new corporation will issue \$500,000 in new debt to Ms. Bond. The remaining consideration will be in the form of common shares with a fair market value and legal stated capital of \$590,000. The new corporation does not have a balance in its General Rate Income Pool (GRIP) account in any of the years under consideration.

**Required:**

- A. What are the tax consequences of making this transfer at the elected value of \$950,000? Your answer should include amounts to be included in Ms. Bond's income as a result of the transfer, as well as the corporation's tax values for the assets.
- B. Compute the adjusted cost base of each component of the consideration that Ms. Bond has received from the corporation.
- C. Compute the PUC of the corporation's newly issued common shares.
- D. What amounts would be included in Ms. Bond's Net Income For Tax Purposes if, during 2016, she sells her common shares for \$650,000?
- E. What amounts would be included in Ms. Bond's Net Income For Tax Purposes if, during 2016, the corporation redeems her common shares for \$650,000?

**TIF PROBLEM SIXTEEN - 12****Transfers To A Corporation And Sale Of Shares**

Mike Danforth has, for a number of years, operated a successful proprietorship involved in retail sales of home improvement products. Mr. Danforth has decided to incorporate his business operations under the name of Danforth Inc. on January 2, 2016 using ITA 85. Danforth Inc. will have a December 31 year end.

On January 1, 2016, the tax values (adjusted cost base or UCC) and fair market values of the assets and liabilities on his Balance Sheet are as follows:

	Tax Value	Fair Market Value
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
<b>Total Assets</b>	<b>\$263,750</b>	<b>\$405,000</b>
Liabilities	( 20,000)	( 20,000)
<b>Net Assets (Owner's Equity)</b>	<b>\$243,750</b>	<b>\$385,000</b>

**Other Information:**

1. The Temporary Investments contain securities that have been purchased in order to absorb a seasonal excess of cash.
2. With respect to the Accounts Receivable, the \$1,250 difference between their tax value and their fair market value reflects Mr. Danforth's estimate of potential bad debts.
3. The new corporation will assume the outstanding liabilities of the proprietorship.
4. In implementing this rollover, Mr. Danforth will be issued new debt. Additional consideration, in excess of the maximum amount of non-share consideration that can be taken without incurring a tax liability, will be taken in the form of common shares.
5. Mr. Danforth will only use the ITA 85 provisions to transfer a specific asset if there is a tax advantage in doing so.
6. On October 1, 2016, Mr. Danforth sells the shares that he received in this rollover for \$208,000. Danforth Inc. is a qualified small business corporation. Mr. Danforth has never used his lifetime capital gains deduction and he has no Cumulative Net Investment Loss.

**Required:**

- A. Advise Mr. Danforth with respect to which assets should be transferred under the provisions of ITA 85(1), and the values that should be elected in order to minimize his current Tax Payable. Indicate the appropriate alternative treatment for any assets that you do not recommend transferring with the use of ITA 85(1).
- B. Assume that Mr. Danforth only uses ITA 85(1) for those assets which you have indicated should be transferred under this provision. What is the maximum amount of non-share consideration that Mr. Danforth can receive without being subject to additional taxation?
- C. Calculate Mr. Danforth's taxable capital gain on the sale of the shares and indicate the effect of the current year sale of shares on his Taxable Income.

**TIF PROBLEM SIXTEEN - 13****Transfers To A Corporation And Sale/Redemption Of Shares**

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

As of January 1, 2016, he is ready to commence business operations and would like to transfer the property to a new corporation using the provisions of ITA 85(1). The new corporation will have a December 31 year end.

With respect to the land, its fair market value has increased to \$400,000. As the building has been periodically used to produce income, it now has a UCC of \$633,600. It is estimated that the fair market value of the building on January 1, 2016 is \$1,400,000. The mortgage on the property has been reduced to \$450,000.

In applying ITA 85(1), Mr. Bodin will elect a value for the land of \$250,000, and a value for the building of \$750,000. The corporation will assume the \$450,000 balance on the mortgage and will issue new debt to Mr. Bodin in the amount of \$400,000. In addition, Mr. Bodin will receive common shares with a fair market value of \$950,000.

There are no additions to the new corporation's General Rate Income Pool during 2016.

**Required:**

- A. What are the tax consequences of making this transfer at the elected value of \$1,000,000? Your answer should include amounts to be included in Mr. Bodin's income as a result of the transfer, as well as the corporation's tax values for the assets.
- B. Compute the adjusted cost base of each component of the consideration that Mr. Bodin has received from the corporation.
- C. Compute the PUC of the corporation's newly issued common shares.
- D. What amounts would be included in Mr. Bodin's Net Income For Tax Purposes if, during 2016, he sells his common shares for \$950,000?
- E. What amounts would be included in Mr. Bodin's Net Income For Tax Purposes if, during 2016, the corporation redeems his common shares for \$950,000?

**TIF PROBLEM SIXTEEN - 14****Transfers To A Corporation And Sale Of Shares**

For the last six years, Ms. Sarah Delmor has operated Delmor Industries as a sole proprietorship. The business has been very successful and, as a consequence, has experienced rapid growth. Given this situation, Ms. Delmor has concluded that in order to enhance her ability to raise additional capital, the assets and liabilities of Delmor Industries should be transferred to a new corporation, Delmor Inc.

On July 1, 2016, the tax values (adjusted cost base or UCC) and fair market values of the assets and liabilities of Delmor Industries are as follows:

	Tax Value	Fair Market Value
Accounts Receivable	\$ 120,000	\$ 112,000
Temporary Investments	42,000	37,000
Inventories	220,000	231,000
Depreciable Assets - CCA Class 8 (Note One)	53,000	61,500
Machinery (Note Two)	197,000	273,000
Land	150,000	311,000
Building (Note Three)	416,000	523,500
Goodwill	Nil	200,000
Total Assets	\$1,198,000	\$1,749,000
Liabilities	( 72,000)	( 72,000)
Net Assets (Owner's Equity)	\$1,126,000	\$1,677,000

**Note One** There are two assets in Class 8. Asset A has a cost of \$27,000 and a fair market value of \$32,500. Asset B has a cost of \$33,000 and a fair market value of \$29,000.

**Note Two** The cost of the Machinery was \$212,500.

**Note Three** The cost of the Building was \$472,000.

The transfer of the Delmor Industries' assets to Delmor Inc. will take place on July 1, 2016, and an election will be made under ITA 85. Delmor Inc. will assume the liabilities of Delmor Industries and, in addition, will issue \$800,000 in new debt to Ms. Delmor. With respect to share consideration, the new Company will issue preferred stock with a fair market value of \$200,000 and common stock with a fair market value of \$677,000.

Any shares issued by Delmor Inc. as part of this rollover will be issued to Ms. Delmor. Delmor Inc. does not have a balance in its General Rate Income Pool (GRIP) account in any of the years under consideration.

**Required:**

- A. Determine whether the Accounts Receivable and Temporary Investments should be transferred under the provisions of ITA 85. Explain your conclusion and, if you recommend that ITA 85 should not be used, indicate the appropriate alternative treatment.
- B. Without regard to your conclusions in Part A, assume that all of the assets are transferred to the new corporation under the provisions of ITA 85. Indicate the minimum values that can be elected for each of the assets. Include a detailed explanation of how the election would apply to Asset A and Asset B in Class 8.

*Transfers To A Corporation And Sale Of Shares*

- C. Assume the transfer of the assets of Delmor Industries to Delmor Inc. is going to be made using the provisions of ITA 85. Ms. Delmor will elect the values that you have determined in Part B, and transfer all of the assets of Delmor Industries (whether or not appropriate) under this rollover provision. Determine the adjusted cost base of the non-share consideration, preferred stock and common stock received by Ms. Delmor. In addition, determine the Paid Up Capital amounts for the preferred stock and the common stock.
- D. Indicate the tax consequences to Ms. Delmor if the preferred stock and common stock that she received in the rollover were immediately redeemed by the new corporation at fair market values.

## **TIF PROBLEM SIXTEEN - 15**

### **Gift To Related Party - Section 85**

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Ms. Bess Chadwick started an unincorporated business several years ago. The business has been extremely successful and is now worth several million dollars. While she is only 32 years old, she would like to retire. She has developed a taste for luxury travel and would like to spend the next two years pursuing that interest before settling down to a life of leisure in Canada.

Her life and business partner for the last four years has been Biff Bangor. At this stage, she has become somewhat bored with him and does not wish to have him join her in her travels. However, he has been a crucial factor in the success of her business, as well as a wonderful human being so, given this, she would like to transfer the business and its future growth to Biff.

In order to implement these decisions, she has arranged for Biff to establish a new corporation by investing \$5,000 in newly issued common shares. At the time of incorporation, the cash of \$5,000 is the only asset of the corporation and Biff owns the only common shares issued by the corporation. The new corporation is named Bangor Executive Services and Supplies (BESS) and will have a December 31 year end.

On January 1, 2016, Ms. Chadwick will transfer most of the business assets from her unincorporated business to BESS. On that date, the tax values (UCC or adjusted cost base) and estimated fair market values of these assets is as follows:

	<b>Tax Value</b>	<b>Fair Market Value</b>
Inventories	\$1,200,000	\$ 1,250,000
Depreciable Assets - CCA Class 8 (Note One)	3,650,000	3,850,000
Land	1,870,000	2,600,000
Building (Note Two)	3,100,000	4,800,000
<b>Total Assets</b>	<b>\$9,820,000</b>	<b>\$12,500,000</b>
Liabilities	( 850,000)	( 850,000)
<b>Net Assets (Owner's Equity)</b>	<b>\$8,970,000</b>	<b>\$11,650,000</b>

**Note One** The capital cost of the assets in Class 8 on January 1, 2016 is \$4,100,000.

**Note Two** The capital cost of the Building was \$3,600,000.

The Accounts Receivable of the business will be transferred under ITA 22 rather than ITA 85. Also, a business valuation has indicated that Ms. Chadwick's business does not have any goodwill.

Ms. Chadwick will transfer the assets at an elected value of \$9,820,000. The new corporation will assume all of the \$850,000 of business liabilities and issue new debt to Ms. Chadwick in the amount of \$1,150,000. She will also receive cash of \$6,000,000 and redeemable preferred shares with a fair market value and a legal stated capital of \$4,500,000.

On review, the CRA issues a reassessment in August, 2016 which increases the fair market value of the land to \$3,100,000, an increase of \$500,000. Ms. Chadwick does not plan to appeal this reassessment as she had been pressed for time and had decided on the \$2,600,000 value without any professional consultation.

**Required:** Ignore the lifetime capital gains deduction in your solution.

- A. Taking into consideration the reassessment, determine the tax consequences to Ms. Chadwick that result from the transfer of her business assets to BESS. Your answer should include amounts to be included in Ms. Chadwick's income as a result of the transfer, as well as the adjusted cost base and PUC of her preferred shares.

- B. Determine the tax consequence to Ms. Chadwick if BESS redeems her preferred shares for \$4,500,000 immediately after they are issued.
- C. After a few months of traveling alone, Bess finds, much to her surprise, that she misses Biff and, in early December, 2016 asks him to join her on her travels. Given this much hoped-for invitation, Biff immediately (before she can change her mind) sells his BESS shares to an arm's length party for \$550,000 and buys a first class ticket to Paris. Determine the tax consequences of this sale for Biff.

**TIF PROBLEM SIXTEEN - 16****Excess Consideration**

For the last 8 years, Mel Gibber has operated Gibber Industries as a sole proprietorship. As his accountant tells him he will save a great deal of income tax if the business is operated through a corporation, he plans to transfer the business to Gibber Inc., a CCPC in which he holds 100 percent of the outstanding shares. This corporation has a December 31 year end.

The transfer will take place on January 1, 2016. Mr. Gibber will use ITA 85(1) to transfer any tangible assets with fair market values in excess of their tax values (adjusted cost base or UCC). These assets, and their relevant values on the date of transfer are as follows:

	Tax Value	Fair Market Value
Depreciable Assets - CCA Class 8 (Note One)	\$123,000	\$ 162,000
Land	220,000	363,000
Building (Note Two)	462,000	587,000
Net Assets (Owner's Equity)	\$805,000	\$1,112,000

**Note One** The capital cost of the assets in Class 8 is \$167,000.

**Note Two** The capital cost of the Building is \$514,000.

The elected value for the Depreciable Assets and the Building will be their tax values, a total of \$585,000. However, because Mel has a net capital loss carry forward of \$18,000 [(1/2)(\$36,000)], the Land will be transferred at an elected value of \$256,000.

As consideration, Mr. Gibber will receive non-share consideration of \$800,000, plus Gibber Inc. redeemable preferred shares with a legal stated capital and a fair market value of \$562,000.

**Required:** Ignore the lifetime capital gains deduction in your solution.

- A. Determine the immediate tax consequences to Mr. Gibber that will result from his transfer of the Gibber Industries assets to Gilmour Ltd.
- B. Indicate the tax values that will be recorded for the assets that are transferred to Gibber Inc. under ITA 85(1).
- C. Determine the tax consequence to Mr. Gibber if, in October, 2016:
  1. He sells his shares to an arm's length party for \$562,000.
  2. Gibber Inc. redeems his preferred shares for \$562,000.

**TIF PROBLEM SIXTEEN - 17****Dividend Stripping**

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Norton Ltd. is a Canadian controlled private corporation, 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 paid up capital of \$225,000. The corporation has a December 31 year end.

The Company has been very successful and, as a consequence, at the beginning of 2016 it is estimated that the current fair market value of the common shares is \$2,465,000. Ms. Chadwick has a serious heart condition that has significantly reduced her life expectancy. As a consequence, she would like to transfer any future increase in value of the Norton Ltd. shares to her companion of the last 25 years, Mr. Bobby Borque. Mr. Borque cohabits with Ms. Chadwick in a conjugal relationship.

In order to accomplish this goal, she intends to have Bobby establish a new Company, Borque Inc. All 100 of the common shares of Borque Inc. will be issued to Bobby, in return for a cash investment of \$1,000.

Once the new company is established, Ms. Chadwick will transfer all of her common shares in Norton Ltd. to Borque Inc. She will make the transfer under the provisions of ITA 85(1), electing a value of \$875,000. It is her intention to take back consideration consisting of a \$875,000 interest bearing note (fair market value = \$875,000) along with retractable preferred shares with a fair market value and a Paid Up Capital of \$1,590,000. The transfer will take place on January 1, 2016.

Neither of the Companies have a balance in their General Rate Income Pool (GRIP) account in any of the years under consideration.

Norton Ltd. is a qualified small business corporation. Ms. Chadwick has used her lifetime capital gains deduction in previous years to eliminate the tax on dispositions of qualified property. As a consequence, for 2016, the balance that remains available is \$650,000.

**Required:**

- A. Explain the tax consequences of the proposed ITA 85(1) transfer of the Norton Ltd. shares to Borque Inc.
- B. Describe how you would change the transaction to improve Ms. Chadwick's tax position, and determine the tax implications that would result from this new approach.
- C. As an alternative approach to using her lifetime 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 fair market value and this would produce, in the absence of ITA 84.1, a capital gain of just over \$650,000. Explain the tax consequences of this proposed transaction.

Show all calculations to support your answers.

**TIF PROBLEM SIXTEEN - 18****Capital Gains Strip**

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Lardley Inc., is a Canadian controlled private company. Ten years ago, it acquired 100 percent of the outstanding shares of Domas Ltd. at a cost of \$300,000.

The Domas shares have a PUC of \$450,000. As the Company has operated very successfully since its acquisition by Lardley, the shares have a current fair market value of \$2,300,000. During the period that Lardley Inc. has owned Domas, safe income of \$565,000 has accrued. Domas has a nil balance in its Refundable Dividend Tax On Hand account.

Neither company has a General Rate Income Pool (GRIP) balance.

**Required:** Indicate the amount, and type, of income that would accrue to Lardley Inc. in both of the following **independent** situations:

- A. Domas Ltd. obtains a bank loan in the amount of \$2,000,000 and uses all of the acquired funds to pay a dividend to Lardley Inc. Subsequent to the receipt of this dividend, Lardley Inc. sells the Domas shares to Ms. Arden, an arm's length party, for \$300,000.
- B. Using ITA 85(1), Lardley transfers the Domas shares to Arden Ltd., an unrelated corporation. The elected value is \$300,000. In return for the Domas shares, Lardley receives Arden Ltd. preferred stock with a PUC of \$300,000 and a redemption value of \$2,300,000. Immediately after the transfer, Arden Ltd. redeems the preferred stock for \$2,300,000.

## **Chapter Seventeen Test Item File Problems**

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### **TIF PROBLEM SEVENTEEN - 1**

#### **Chapter 17 - Essay Questions**

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1. Describe, in general terms, the type of situation in which ITA 85.1, Share For Share Exchange, is used. What is the major tax advantage of using this rollover provision?
2. Briefly describe the general rules applicable to the vendor in a Section 85.1 share for share exchange.
3. There are several conditions that are required for an ITA 85.1 rollover to be applicable. List three of these conditions.
4. The provisions of ITA 85.1, share for share exchange, apply automatically unless the vendor opts out. How does the vendor opt out of this Section?
5. Jerome Barris is 85 years old and, while his spouse is deceased, he has three children, ages 45, 50, and 52. He owns all of the outstanding common shares of Barris Ltd., a Canadian controlled private corporation. These shares have a PUC and adjusted cost base of \$50,000, and a current fair market value of \$3 million. He would like to retain operating control of Barris Ltd. However, given his advanced age, he would like to transfer any future growth in the value of the Company to his three children. Briefly explain how ITA 86, Exchange Of Shares In A Reorganization, could be used to accomplish the results desired by Mr. Barris.
6. Several conditions must be met in order for the provisions of ITA 86, exchange of shares in a reorganization, to apply. List two of these conditions.
7. When preferred shares are issued in an ITA 86(1) reorganization, it is important that they contain provisions which establish the market value of such shares. List three provisions that are used to accomplish this goal.
8. When new shares are issued in an ITA 86(1) or ITA 86(2) reorganization, how is their adjusted cost base determined?
9. When new shares are issued in an ITA 86(1) or ITA 86(2) reorganization, how is their paid up capital determined?
10. In a reorganization of capital under ITA 86, it is necessary to calculate both a proceeds of redemption and a proceeds of disposition. How do these two calculations differ if there is no gift involved?
11. Briefly describe the calculation of the PUC of new shares issued in a reorganization of capital under ITA 86(1).
12. ITA 86(2) has special rules that must be applied when a Section 86 reorganization involves a gift to a related party. What circumstances create such a gift situation?
13. When a reorganization of capital involves a gift to a related person, the provisions of ITA 86(2) modify the rules applicable to such reorganizations. Briefly describe the main changes that result from these modifications.
14. Estate freezes can be carried out using either ITA 85(1) or ITA 86(1). What are the major advantages of using ITA 86(1), rather than ITA 85(1)?
15. List two conditions that are necessary for the ITA 87 amalgamation legislation to apply.

16. What is the tax position of the shareholders of a company that has been combined with another company under the provisions of ITA 87, Amalgamations.
17. Subsections 88(1) and 88(2) cover two different types of transactions. Describe these two types of transactions.
18. Both ITA 87, Amalgamations, and ITA 88(1), Wind-Up Of A 90 Percent Owned Subsidiary, provide for a bump-up of asset values. Describe the two basic limits on the amount of this bump-up.
19. If a parent company wishes to incorporate the assets of a majority owned subsidiary into its operations, this goal can be accomplished either through an amalgamation, under ITA 87, or through the wind-up procedures established in ITA 88(1). Briefly describe the different tax effects that result from choosing one or the other of these alternative procedures.
20. When a corporation is wound up under the provisions of ITA 88(2), assets will be sold and liabilities will be settled. When the resulting proceeds are distributed to shareholders, the distribution will usually be made up of several different components. Briefly indicate the components that can be included in this type of distribution.
21. Companies sometimes issue bonds that can be converted, at the discretion of the holder, into common shares of the company. In general, conversion will only occur if the fair market value of the common shares available upon conversion exceed the fair market value of the bonds. What are the tax consequences to the holder of such bonds when they exercise their option to convert?
22. When a taxpayer receives a payment for signing a restrictive covenant, the general rule is that the full amount must be included in the taxpayer's income when it is received or receivable. The proposed legislation on this subject provides for three exceptions to this general rule. Briefly describe these exceptions.
23. The vendor of a business may have a significant amount of assets that are used under the provisions of capital leases. In most situations, any existing leasing arrangements can be transferred in the process of selling a business. Further, some leased properties may have experienced significant increases in value (e.g., a long-term lease on office space in a market where such space has become scarce). In such circumstances, a long-term lease may be of significant value to the purchaser of a business. Despite the presence of such values, it is not uncommon for leases to be ignored in the purchase agreement and, as a consequence, in the allocation of tax values for the purchasing company. This, in effect, means that the value of these leases ends up as a component of purchased goodwill. Discuss the tax consequences, to both the purchaser and the vendor, of not specifying the value of any long-term capital leases in the agreement of purchase and sale of a business.
24. When the assets of a Canadian controlled private corporation are sold, the following assets will usually be involved in the sale:
  - Accounts Receivable
  - Inventory
  - Depreciable Assets
  - GoodwillBriefly describe the tax implications resulting from the sale of each of the preceding types of assets to the selling company.
25. In general, the purchaser of a corporation would prefer to buy its assets rather than its shares. Provide three reasons for this preference.

**TIF PROBLEM SEVENTEEN - 2****Chapter 17 - True Or False**

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**New For 2016/2017**

1. In an ITA 85.1 share-for-share exchange, the vendor must not receive any non-share consideration.

True or False?

2. ITA 85.1 was designed to be used in situations where a public company acquires a widely held corporation with a large number of shareholders.

True or False?

3. In an ITA 86(1) exchange of shares in a reorganization, the transferor cannot receive any non-share consideration.

True or False?

4. When used in an ITA 86(1) exchange of shares in a reorganization, preferred shares cannot have voting rights.

True or False?

5. In an ITA 86 exchange of shares in a reorganization, if the transaction involves a gift to a related party, the proceeds of the disposition for capital gains purposes on the old shares will be equal to the lesser of:

- the non-share consideration, plus the gift and
- the fair market value of the old shares.

True or False?

6. In an ITA 87 amalgamation, losses carried forward from the amalgamating companies cannot be used by the amalgamated company until the first taxation year beginning subsequent to the amalgamation.

True or False?

7. When a 90 percent owned subsidiary is wound up under the provisions of ITA 88(1), the subsidiary will not be able to claim CCA in its final year as a separate entity.

True or False?

8. If, when a corporation is wound up under the provisions of ITA 88(2), the distribution of assets to the shareholders exceeds the PUC of the shares being cancelled, the excess will be treated as a capital gain, one-half of which will be included in the taxpayer's Net Income For Tax Purposes.

True or False?

9. If an investor uses a conversion provision to exchange his debt securities for common shares in the same company, there is a rollover provision which can prevent any excess of the value of the common stock over the value of the debt security from being subject to tax.

True or False?

10. When a taxpayer receives a payment for agreeing to a restrictive covenant, the taxpayer will always have to include the full amount in his Net Income For Tax Purposes.

True or False?

### **Retained From Previous Editions**

11. In a share for share exchange under ITA 85.1, the transferor cannot control the acquiring company subsequent to the rollover transaction.

True or False?

12. The most common application of the ITA 86 exchange of shares in a reorganization is to transfer an unincorporated business to a corporation.

True or False?

13. In an ITA 86 exchange of shares in a reorganization, the transferor must transfer all of the shares of all classes that he owns in the transferee corporation.

True or False?

14. In an ITA 86 exchange of shares in a reorganization, if the transferor received non-share consideration in excess of the PUC of the old shares, the PUC of the new shares issued will be reduced to nil.

True or False?

15. In an ITA 86 exchange of shares in a reorganization, if the transferor receives shares with a fair market value that is greater than the fair market value of the shares given up, it may be considered a gift to a related party.

True or False?

16. If a parent company has a subsidiary, its assets can always be transferred to the parent on a tax free basis using either an ITA 87 amalgamation or, alternatively, an ITA 88(1) winding-up of a 90 percent owned subsidiary.

True or False?

## TIF PROBLEM SEVENTEEN - 3

### Chapter 17 - Multiple Choice

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#### New For 2016/2017

- Which of the following statements about ITA 85.1 is **NOT** correct?
  - This provision is commonly used in business combination transactions.
  - The vendor and the purchaser must be dealing with each other at arm's length.
  - The vendor can receive a combination of shares and non-share consideration in return for the shares he is giving up.
  - The vendor will be deemed to have disposed of his shares for proceeds equal to their adjusted cost base.
- Jerome Owen owns 70 percent of the common shares of Nexto Ltd. Jerome's shares have an adjusted cost base of \$1,050,000. The Nexto common shares have a total PUC of \$2,300,000 and a total fair market value of \$2,500,000. Using the provisions of ITA 86, Jerome exchanged his shares for cash of \$1,050,000 and preferred shares with a legal stated capital and fair market value of \$700,000. What is the PUC of Jerome's preferred shares.
  - Nil.
  - \$560,000.
  - \$140,000.
  - \$700,000
- With respect to the application of ITA 87 to amalgamations, which of the following statements is correct?
  - Any capital dividend accounts that existed in the records of the two predecessor companies cannot be carried forward.
  - There is no "bump-up" of the asset values of the two predecessor companies.
  - Losses of the two predecessor company cannot be used until the first taxation year of the amalgamated company that begins after the date of the amalgamation.
  - The depreciable capital property of the predecessor companies will be carried forward to the tax records of the amalgamated company at UCC values.
- Which of the following statements related to ITA 87 amalgamations is correct?
  - An amalgamation cannot increase the total amount of income eligible for the manufacturing and processing deduction.
  - By bringing together a profitable and an unprofitable company, an amalgamation can result in a faster write off of capital assets through CCA deduction.
  - An acquisition of control can be effected through an amalgamation which would enable prior year net capital losses of both predecessor companies to be used.
  - After an amalgamation, the losses of one of the predecessor companies cannot be used against the taxable income of the other predecessor company.
- Which of the following statements is **NOT** correct with respect to the asset bump up available in some ITA 87 amalgamations and wind-up transactions under ITA 88(1)?
  - The bump up is available in a vertical amalgamation when the parent company owns 100 percent of the subsidiary and in a wind up when the parent company owns 90 percent or more of the subsidiary.
  - The bump up is only available in a wind up when the parent company owns 100 percent of the subsidiary.
  - In a wind up, the bump up is only available on non-depreciable assets of the subsidiary.
  - In a vertical amalgamation, the bump up is only available on the non-depreciable assets of the subsidiary.

6. Danton is the only shareholder of a corporation that has liquidated all of its assets. After paying all of its liabilities, there is \$450,000 in cash available for distribution on the winding up. The common shares have a PUC of \$45,000, Danton's adjusted cost base is \$80,000 and there is a balance in the company's capital dividend account of \$51,000. There is no balance in the company's GRIP account. The distribution to Danton is:
  - A. A capital dividend of \$51,000, along with a taxable non-eligible dividend of \$354,000.
  - B. A capital dividend of \$51,000, along with a taxable eligible dividend of \$354,000.
  - C. Return of capital of \$45,000, along with a taxable non-eligible dividend of \$405,000.
  - D. A capital dividend of \$51,000, along with a taxable non-eligible dividend of \$405,000.
7. Indicate which of the following features would be considered an advantage of acquiring assets rather than shares in the purchase of an incorporated business.
  - A. The availability of the lifetime capital gains deduction.
  - B. The ability to carry forward non-capital losses after the acquisition.
  - C. The ability to recognize the acquired company's goodwill.
  - D. The ability to avoid land transfer tax.

## **Retained From Previous Editions**

### ***Share For Share Exchanges - ITA 85.1***

8. An individual owns 100 percent of the shares of a CCPC. He wishes to exchange these shares for shares of a large public company without incurring a tax liability. Which roll-over provision would be the easiest to use for this purpose?
  - A. ITA 85(1) - Transfer of property to a corporation.
  - B. ITA 87 - Amalgamation.
  - C. ITA 85.1 - Share for share exchange.
  - D. ITA 51 - Convertible property.
9. Which of the following is **NOT** an advantage that can be obtained by using ITA 85.1 in a situation where a diverse group of shareholders will exchange their shares in one company for shares in an acquiring corporation?
  - A. There is no need for each shareholder to file an election, the provisions of ITA 85.1 apply automatically
  - B. Individual vendors may choose to defer the gain from the transaction in their income.
  - C. The vendor can receive cash equal to an amount of the PUC of the shares tax-free.
  - D. Individual vendors may choose to include the gain or loss from the transaction in their income.
10. Ms. Takase is the sole shareholder of Takase Ltd. She owns 2,500 shares with a PUC and adjusted cost base of \$400,000, and a fair market value of \$1,000,000. Giant Holdings Ltd. acquires these shares in return for 10,000 of its common shares, which are currently trading for \$100 per share. The rollover is completed using ITA 85.1. The results of the transaction will be:
  - A. Ms. Takase will report a capital gain of \$600,000 as a result of her deemed disposition. The adjusted cost base of her new shares in Giant Holdings Ltd. will be nil.
  - B. Ms. Takase will be deemed to have disposed of her Takase Ltd. shares for an amount equal to their adjusted cost base. There will not be a capital gain to report on this disposition.
  - C. The shares of Giant Holdings Ltd. that Ms. Takase acquires will have a deemed adjusted cost base of \$1,000,000, the greater of the fair market value and the PUC of the Takase Ltd. shares. There will not be a capital gain to report on this disposition.
  - D. The shares of Giant Holdings Ltd. that Ms. Takase acquires will have a deemed PUC of \$1,000,000. She will report a capital gain on the disposition of \$600,000.

11. Tiffany owns shares in the public corporation, Zoom Inc. She has received an offer from the public corporation Mooz Inc. to exchange all of her shares in Zoom Inc. Her adjusted cost base for these shares is \$28,000. They have a fair market value of \$39,000 and a PUC of \$10,000. Her Zoom shares would be exchanged for shares of Mooz Inc. with a fair market value of \$39,000 and a legal stated capital of \$39,000. What is the adjusted cost base of the Mooz Inc. shares received by Tiffany under the provisions of Section 85.1, "Share For Share Exchanges"?
- A. \$10,000
  - B. \$28,000
  - C. \$33,500
  - D. \$39,000

**Exchange Of Shares In A Reorganization - ITA 86(1) And (2)**

12. Several conditions are required in order that the provisions of ITA 86 (Exchange Of Shares In A Reorganization) apply. Which one of the following conditions is **NOT** required?
- A. All of the outstanding shares of the particular class must be exchanged.
  - B. The transferor of the original shares must receive shares of the reorganized corporation as consideration for his shares.
  - C. The new shares that will be issued must be authorized by the corporation's articles of incorporation (currently, or through an amendment prior to the reorganization).
  - D. The original shares must be held by the owner as capital property.
13. When preferred shares are issued in an ITA 86 reorganization, it is important that they have characteristics that serve to establish their fair market value. Which of the following would **NOT** be useful in establishing the fair market value of preferred shares?
- A. A fixed dividend rate.
  - B. A claim to assets that has priority over the common shares in the event of liquidation.
  - C. A provision which requires redemption at a specified value at the discretion of the shareholder.
  - D. Voting rights.
14. With respect to an exchange of shares in an ITA 86 reorganization, which of the following statements is **NOT** correct?
- A. The cost of the new shares will be equal to the cost of the old shares, reduced by the non-share consideration received.
  - B. The PUC of the new shares will be equal to their legal stated capital.
  - C. The proceeds of redemption will be equal to the PUC of the new shares, plus any non-share consideration received.
  - D. The proceeds of disposition will be equal to the cost of the new shares, plus any non-share consideration received.
15. John Smurt owns 80 percent of the common shares of Smurt Ltd. John's shares have an adjusted cost base of \$600,000. The Smurt common shares have a total PUC of \$1,000,000, and a total fair market value of \$2,500,000. Using the provisions of ITA 86, John exchanged his shares for cash of \$600,000 and preferred shares with a legal stated capital and fair market value of \$1,400,000. What is the adjusted cost base of John's preferred shares?
- A. Nil.
  - B. \$250,000.
  - C. \$1,400,000.
  - D. \$650,000.

16. Jeri Nardwal owns 80 percent of the common shares of Nardwal Ltd. Her son owns the other 20 percent. Her common shares have an adjusted cost base and PUC of \$960,000. The fair market value of her shares is \$4,800,000. She exchanges these shares for \$500,000 in cash and preferred shares with a legal stated capital and fair market value of \$3,840,000. What is the adjusted cost base of the preferred shares?
- A. \$460,000.
  - B. \$3,840,000.
  - C. Nil.
  - D. \$960,000.
17. Mamma Mia is the sole shareholder of iPasta. She would like her son to eventually take-over the company so she can retire. If she chooses to use ITA 86, "Exchange Of Shares In A Reorganization", which of the following statements is correct?
- A. Mamma Mia could restructure the ownership of her company, which would result in no immediate tax consequence for herself, with future growth accruing to her son.
  - B. Mamma Mia could restructure the ownership of her company, which would result in an immediate tax consequence for herself, with future growth accruing to her son.
  - C. Mamma Mia could restructure the ownership of her company, which would result in an immediate tax consequence for her son, with future growth accruing to her son.
  - D. Mamma Mia could restructure the ownership of her company, but her son must purchase her common shares at their fair market value to have future growth accruing to him.
18. Mr. Couture would like to transfer his corporation to his son who has started to work in the business. His son will not have the funds to purchase all of the shares for at least 5 years. Which of the following will permit Mr. Couture to transfer the future growth of the company to his son without any immediate tax effect for himself?
- A. A sale of his shares to his son with payment in 5 years
  - B. A reorganization of share capital
  - C. An amalgamation
  - D. A wind-up

***Amalgamations - ITA 87 And ITA 88(1)***

19. Which of the following is **NOT** one of the conditions necessary for the ITA 87(1) (amalgamation) rollover to apply?
- A. All the predecessor corporations must be Canadian controlled private corporations.
  - B. All shareholders of the predecessor corporations must receive shares of the amalgamated corporation as a result of the amalgamation.
  - C. All of the assets and liabilities of the predecessor corporations, other than intercompany balances, must be transferred to the amalgamated corporation in the amalgamation.
  - D. The transfer must be supported by corporate legislation that identifies the transaction as an amalgamation.
20. Which of the following values will **NOT** flow through from a predecessor company to an amalgamated company as a result of an amalgamation under ITA 87?
- A. RDTOH of a public company.
  - B. GRIP when the amalgamated company is a CCPC.
  - C. Non-capital losses.
  - D. Net capital losses.

21. Shareholders of predecessor corporations that amalgamate are deemed to have disposed of their shares for proceeds equal to the adjusted cost base of the shares as long as certain conditions are met. Which of the following is **NOT** one of the necessary conditions?
- A. The shareholders must not receive any consideration other than shares of the amalgamated company.
  - B. The original shares must be capital property of the shareholders.
  - C. The shareholders must receive non-share consideration that is equal to the adjusted cost base of their shares.
  - D. The amalgamation must not result in a deemed gift to a person related to the shareholders.
22. In a situation where a parent decides to combine with a subsidiary, which of the following statements is correct?
- A. If the parent owns 90% or more of any class of capital stock of the subsidiary, it is possible to combine the companies using either ITA 87 or ITA 88(1).
  - B. If the parent owns 90% or more of any class of capital stock of the subsidiary, it will be able to take advantage of a bump up in asset values, regardless of the approach taken to complete the transaction.
  - C. If the parent owns 90% or more of the shares of each class of capital stock of the subsidiary, it will be able to take advantage of a bump up in asset values, regardless of the approach taken to complete the transaction.
  - D. If the parent owns 90% or more of the shares of each class of capital stock of the subsidiary, it is possible to combine the companies using either ITA 87 or ITA 88(1).
23. Two unrelated companies, one of which has both non-capital and net capital losses to carry forward, are amalgamated on January 1, 2016. The resulting new company is Parent Inc. All three companies have a December 31 year end. After amalgamation, the shareholders of the company with losses own 10% of Parent Inc. and the shareholders of the other company own 90%. During the year ended December 31, 2016, Parent Inc. has Net Income for Tax Purposes which includes a taxable capital gain. Parent Inc. continues to carry on the businesses of both amalgamated corporations.
- Which of the following statements best describes the situation of Parent Inc. with respect to the deduction of the losses incurred prior to amalgamation?
- A. All losses carried forward from the predecessor companies will be deductible to Parent Inc. as soon as the amalgamation is completed.
  - B. Parent Inc. will not be able to carry any of the losses forward and use them against income of the amalgamated company.
  - C. Parent Inc. will be able to utilize the non-capital loss against profits from the same business in which the loss was incurred beginning in the 2016 taxation year. The net capital losses cannot be utilized by Parent Inc.
  - D. Parent Inc. will be able to utilize the non-capital loss against profits from the same business in which the loss was incurred beginning in the 2017 taxation year. The net capital losses cannot be utilized by Parent Inc.
24. Which of the following conditions is **NOT** necessary for an amalgamation to result in a tax-free combination?
- A. It must be supported by corporate legislation which identifies the transaction as an amalgamation.
  - B. All of the predecessor corporations must be Canadian controlled private corporations.
  - C. All of the assets and liabilities of the predecessor corporations, other than intercompany balances, must be transferred to the amalgamated corporation in the amalgamation.
  - D. All shareholders of the predecessor corporations must receive shares of the amalgamated corporation due to the amalgamation.

**Winding Up Of A 90 Percent Owned Corporation - ITA 88(1)**

25. With respect to the application of ITA 88(1), winding up of a 90 percent owned subsidiary, which of the following statements is **NOT** correct?
- A. A write up of non-depreciable capital property may be available.
  - B. Both the subsidiary and the parent will have a deemed year end.
  - C. Subsidiary losses will become available to the parent company in its first taxation year which begins after the windup.
  - D. The tax values of the subsidiary assets will be carried forward to tax records of the parent company.
26. With respect to the application of ITA 88(1), winding up of a 90 percent owned subsidiary, which of the following statements is **NOT** correct?
- A. The GRIP balance will flow through to the parent company if both the subsidiary and the parent were CCPC's before the windup.
  - B. LRIP balances will only flow through to the parent if the subsidiary was a CCPC.
  - C. The subsidiary is deemed to have disposed of its assets at their cost amount, which is an amount that is defined differently for different asset types.
  - D. The subsidiary will not claim CCA on its assets in the year of the windup, but the parent is able to claim CCA on subsidiary assets in the windup year.
27. Okanagan Limited has a November 30 year end, while its 95 percent owned subsidiary Valley Limited has a March 31 year end. Valley Limited is wound up using the rollover provisions of ITA 88(1) on September 15, 2016. At the time, Valley Limited has a non-capital loss of \$150,000 for the period from April 1 to September 15, 2016. The earliest taxation year in which Okanagan Limited can make use of the \$150,000 loss is the taxation year ending:
- A. September 15, 2017.
  - B. November 30, 2017.
  - C. November 30, 2018.
  - D. March 31, 2017.
28. What is the purpose of the bump up in the tax values of the assets of a subsidiary that is sometimes available in a vertical amalgamation or wind up of a 90% owned subsidiary?
- A. The bump up gives full recognition to the fact that the cost of acquiring a subsidiary usually exceeds both the total carrying values and total fair values of the subsidiary's net assets.
  - B. The bump up gives partial recognition to the fact that the cost of acquiring a subsidiary usually exceeds both the total carrying values and total fair values of the subsidiary's net assets.
  - C. The bump up gives partial recognition to the fact that the cost of acquiring a subsidiary always exceeds the total carrying values and total fair values of the subsidiary's net assets.
  - D. The bump up gives full recognition to the fact that the cost of acquiring a subsidiary exceeds the total carrying values and total fair values of the subsidiary's net assets.

**Winding Up Of A Canadian Corporation - ITA 88(2)**

29. Jasmine Lee owns all of the shares of Tee Ltd. Her adjusted cost base for these shares is \$50,000. Because of declining sales, she has decided to wind up the Company under the provisions of ITA 88(2) and, after the assets have been sold and all corporate taxes paid, there is \$2,000,000 available for distribution. The balances in the tax accounts of Tee Ltd. are as follows:

Paid Up Capital	\$ 100,000
RDTOH	Nil
Capital Dividend Account	400,000

If Jasmine properly files all elections that would minimize the tax effect of the distribution, of the following statements, which one is correct?

- A. Jasmine will receive dividends subject to tax of \$1,500,000 (before any gross up), as well as a taxable capital gain of \$25,000, when she receives the \$2,000,000 distribution.
  - B. Jasmine will have a taxable capital gain of \$975,000 when she receives the \$2,000,000 distribution.
  - C. As a rollover provision is being used, there will be no current tax consequences when she receives the \$2,000,000 distribution.
  - D. Jasmine will receive dividends subject to tax of \$1,500,000 (before any gross up), as well as a taxable capital gain of \$225,000, when she receives the \$2,000,000 distribution.
30. Ku Jung owns all of the shares of Jay Ltd. His adjusted cost base for these shares is \$5,000. He has decided to retire, and has wound up the Company under the provisions of ITA 88(2). After the assets have been sold and all corporate taxes paid, there is \$700,000 available for distribution. The balances in the tax accounts of Jay Ltd. are as follows:

Paid Up Capital	\$ 1,000
RDTOH	20,000
GRIP Account	30,000
Capital Dividend Account	100,000

If Mr. Jung properly files all elections that would minimize the tax effect of the distribution, what is the maximum amount he could receive tax free?

- A. \$1,000
- B. \$5,000
- C. \$100,000
- D. \$101,000

**Convertible Properties**

31. Ariella Buxo owns convertible bonds of Lion Holdings Inc. Ariella acquired these bonds at their par value of \$100,000. The bonds are convertible into 1,000 shares of the common stock of Lion Holdings Inc. At the time of her purchase of the bonds, the common shares were trading at \$95 per share. The bonds are converted when the common shares are trading at a price of \$125 per share. The conversion of the bond takes place under the provisions of ITA 51 and will result in:

- A. A capital gain of \$25,000.
- B. No capital gain.
- C. A deemed dividend of \$25,000.
- D. A capital gain of \$30,000.

32. Which of the following is one of the conditions required for ITA 51 (Convertible Properties) to apply?
- A. The exchange must be part of a reorganization of capital or a rollover of property by shareholders to a corporation.
  - B. The exchange must involve non-share consideration.
  - C. The exchange must involve an exchange of convertible debt for common or preferred shares.
  - D. The exchange must not involve any consideration other than the securities being exchanged.

***Sale Of An Incorporated Business***

33. Nancy recently received an offer for the shares of her corporation, Eager Beaver Consultants Ltd. Nancy's shares have an adjusted cost base of \$600,000. The Company is not a qualified small business corporation for purposes of the lifetime capital gains deduction. Although Nancy would like to sell her shares and retire, she will only sell her shares if her after tax retention from the sale totals at least \$2 million. Assuming that Nancy's combined federal and provincial marginal tax rate is 50 percent, what is the minimum price Nancy should accept for her shares?
- A. \$2,466,667.
  - B. \$4,600,000.
  - C. \$2,840,000.
  - D. \$3,400,000.
34. During the current year, all of the assets of Linden Enterprises, a Canadian controlled private corporation, were sold. Among the assets was goodwill with a fair market value of \$425,000. As the goodwill was internally generated, the balance in the corporation's cumulative eligible capital account was nil. Which of the following statements is correct?
- A. Linden will report active business income of \$318,750, with no addition to the capital dividend account.
  - B. Linden will report a taxable capital gain of \$212,500, and there will be a \$212,500 addition to the capital dividend account.
  - C. Linden will report active business income of \$212,500, and there will be a \$212,500 addition to the capital dividend account.
  - D. Linden will report active business income of \$318,750, and there will be a \$106,250 addition to the capital dividend account.
35. Yamaguchi Inc purchases all the assets of Ito Inc. after months of negotiation. All of the assets acquired have fair market values in excess of their related tax values. Which of the following will **NOT** be a result of this transaction?
- A. Yamaguchi will obtain a higher tax value for the assets transferred resulting in higher future CCA deductions.
  - B. Goodwill can be recognized and as a result, Yamaguchi will be able to take CEC deductions in the future.
  - C. Yamaguchi will be held liable for future tax reassessments of Ito Inc.
  - D. The non-capital loss carry forward of Ito Inc. will be lost and cannot be utilized by Yamaguchi Inc.
36. Mr. Germotte has two offers to purchase his solely owned corporation, one for the assets, one for the shares. In considering the asset offer, which of the following statements is correct?
- A. The sale of assets will avoid having to take the corporation through a winding-up procedure.
  - B. Mr. Germotte can take advantage of the lifetime capital gains deduction if the corporation is a qualified small business corporation.
  - C. Mr. Germotte may be subject to taxes on business income and capital gains.
  - D. The corporation may be subject to taxes on business income and capital gains.

## TIF PROBLEM SEVENTEEN - 4

### Chapter 17 - Exam Exercises

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#### *Exam Exercise Subject Listing For Chapter 17*

<b>Number</b>	<b>Subject</b>
1	Share For Share Exchange
2	Share For Share Exchange
3	Exchange Of Shares In Reorganization
4	Exchange Of Shares In Reorganization
5	Exchange Of Shares In Reorganization
6	Exchange Of Shares In Reorganization
7	Gift To A Related Party
8	Gift To A Related Party
9	ITA 87 Amalgamations
10	ITA 87 Amalgamations
11	Winding-Up Of A 90 Percent Owned Subsidiary
12	Winding-Up Of A 90 Percent Owned Subsidiary
13	Winding-Up Of A 90 Percent Owned Subsidiary
14	Winding-Up Of A Canadian Corporation
15	Winding-Up Of A Canadian Corporation

**Exam Exercise Seventeen - 1 (Share For Share Exchange)**

Mr. Morgan Forbes is the sole shareholder of Forbes Ltd., a Canadian controlled private corporation that is not a qualified small business corporation. The corporation was established several years ago by Mr. Forbes with an investment of \$540,000. It has identifiable net assets with a fair market value of \$2,640,000. The shares of his Company are acquired by a large publicly traded company, Megopolis Ltd., through the issuance of 75,000 new Megopolis shares. At the time of this business combination, the Megopolis Ltd. shares are trading at \$36 per share. Indicate the tax consequences of this transaction to both Mr. Forbes and Megopolis Ltd.

**Exam Exercise Seventeen - 2 (Share For Share Exchange)**

Farnum Ltd. is a Canadian controlled private corporation that was established by Freddy Farnum with an original investment of \$400,000. Farnum Ltd. is not a qualified small business corporation. In 2015, Freddy sold all of the shares to John Gage for \$700,000. In early, 2016, John is approached by a large public company, Gross Enterprises, that offers him 200,000 of their shares in return for all of John's shares. The offer is accepted by John and, at this time, the shares of Gross Enterprises are trading at \$6 per share. Indicate the tax consequences of this transaction to both John and Gross Enterprises.

**Exam Exercise Seventeen - 3 (Exchange Of Shares In Reorganization)  $ACB=PUC$**

Ms. Laura Cooper is the sole shareholder of Cooper Inc. It is a Canadian controlled private corporation and its common shares have a fair market value of \$2,950,000, an adjusted cost base (ACB) of \$1,375,000, and a paid up capital (PUC) of \$1,375,000. At this time, Cooper Inc. has no balance in its GRIP account. Ms. Cooper exchanges all of her Cooper Inc. shares for cash of \$1,375,000 and preferred shares that are redeemable for \$1,575,000.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction. Show your calculations.

**Exam Exercise Seventeen - 4 (Exchange Of Shares In Reorganization)  $ACB=PUC$**

Sundance Ltd. is Canadian controlled private corporation. All of its shares have always been owned by Rob Red. The shares have a fair market value \$900,000, a PUC of \$200,000, and an adjusted cost base of \$200,000. The Company has no balance in its GRIP account. At this time, Mr. Red exchanges all of his Sundance shares for cash of \$200,000 and preferred shares that are redeemable for \$700,000.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction. Show your calculations.

**Exam Exercise Seventeen - 5 (Exchange Of Shares In Reorganization)  $ACB>PUC$**

Ms. Samantha Shields is the sole shareholder of Shields Ltd. It is a Canadian controlled private corporation and its common shares have a fair market value of \$920,000, an adjusted cost base (ACB) of \$500,000, and a paid up capital (PUC) of \$400,000. At this time, Shields Ltd. has no balance in its GRIP account. Ms. Shields exchanges all of her Shields Ltd. shares for cash of \$480,000 and preferred shares that are redeemable for \$440,000.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction. Show your calculations.

**Exam Exercise Seventeen - 6 (Exchange Of Shares In Reorganization) ACB<PUC**

Mr. Hal Brook is the only shareholder of HB Ltd., a Canadian controlled private corporation. The shares of the Company have a fair market value of \$1,450,000, an adjusted cost base of \$400,000, and a PUC of \$700,000. The Company has no balance in its GRIP account. At this time, Mr. Brook exchanges all of his HB Ltd. common shares for cash of \$700,000 and HB Ltd. preferred shares that are redeemable for \$750,000.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction. Show your calculations.

**Exam Exercise Seventeen - 7 (Gift To A Related Party)**

Mr. Jean Doyen owns 80 percent of the shares of Jondon Inc. His shares have an adjusted cost base (ACB) of \$420,000. The remaining shares are held by his 19 year old son and his shares have an ACB of \$105,000. The corporation is a Canadian controlled private corporation and its shares have a total fair market value of \$3,360,000 and paid up capital (PUC) of \$525,000. During 2016, Mr. Doyen exchanged all of his Jondon Inc. shares for cash of \$630,000 and preferred shares that are redeemable for \$1,680,000. At this time, Jondon Inc. has no balance in its GRIP account.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction. Show your calculations.

**Exam Exercise Seventeen - 8 (Gift To A Related Party)**

Margaret Hutch owns 60 percent of the shares of MH Inc., a Canadian controlled private company. Her shares have an adjusted cost base (ACB) of \$300,000. Her common-law partner, Jane Evans, owns the remaining 40 percent and her shares have an ACB of \$200,000. The shares of the Company have a fair market value of \$2,300,000 and a PUC of \$500,000. During 2016, Ms. Hutch exchanges all of her MH Inc. shares for cash of \$350,000 and preferred shares that are redeemable for \$830,000. MH Inc. does not have a balance in its GRIP account.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction. Show your calculations.

**Exam Exercise Seventeen - 9 (ITA 87 Amalgamations)**

During its taxation year ending December 31, 2015, Loser Inc. incurs a non-capital loss of \$74,400 and an allowable capital loss of \$120,000. Neither loss can be carried back. On January 1, 2016, using the provisions of ITA 87, the Company is amalgamated with Winner Ltd., a company that also has a December 31 year end. The combined company is named Combo Inc. and it elects to use a December 31 year end. The terms of the amalgamation give 16,000 Combo Inc. shares to the Loser Inc. shareholders, and 120,000 Combo Inc. shares to the Winner Ltd. shareholders.

During the year ending December 31, 2016, Combo Inc. has Net Income For Tax Purposes of \$960,000, including over \$240,000 in taxable capital gains. Will Combo Inc. be able to deduct the losses incurred by Loser Inc. prior to the amalgamation during its 2016 taxation year? Explain your conclusion.

**Exam Exercise Seventeen - 10 (ITA 87 Amalgamations)**

For the year ending December 31, 2015, Hub Ltd. has an allowable capital loss of \$115,000, as well as a non-capital loss of \$85,000. Neither of these losses can be carried back. The Company has no loss carry forwards from years prior to 2015.

On January 1, 2016, using the provisions of ITA 87, Hub Ltd. is amalgamated with Core Inc. The combined Company is named Hubcore Ltd. and, because Core is much larger than Hub, its shareholders receive the majority of voting shares in the combined company. Hubcore will have a December 31 year end.

During the year ending December 31, 2016 Hubcore has Net Income For Tax Purposes of \$200,000. This total is made up \$85,000 in taxable capital gains and \$115,000 of net business income. Of the \$115,000 in net business income, \$52,000 was earned by the division that continued to pursue Hub's line of business.

Will Hubcore Ltd. be able to deduct the losses incurred by Hub Ltd. prior to the amalgamation during the taxation year that ends on December 31, 2016? Explain your conclusion.

**Exam Exercise Seventeen - 11 (Winding-Up Of A 90 Percent Owned Subsidiary)**

On January 1, 2012, Chipper Ltd. acquired 100 percent of the outstanding shares of Intell Inc. at a cost of \$1,800,000. At this point in time, the fair market value of Intell's identifiable net assets was \$1,275,000, including \$405,000 for the Land. The tax values of the net assets at that time totalled \$615,000.

On December 31, 2016, there is a winding-up of Intell Inc. under the provisions of ITA 88(1). Intell Inc. has paid no dividends since its acquisition by Chipper Ltd. On December 31, 2016, the condensed Balance Sheet of Intell Inc. is as follows:

Cash	\$180,000
Land - At Cost (Purchased In 2008)	210,000
Depreciable Assets - At UCC (Purchased In 2008)	360,000
<u>Total Assets</u>	<u>\$750,000</u>
Liabilities	\$112,500
Shareholders' Equity	637,500
<u>Total Equities</u>	<u>\$750,000</u>

Determine the tax values that will be recorded for Intell Inc.'s assets after they have been incorporated into the records of Chipper Ltd.

**Exam Exercise Seventeen - 12 (Winding-Up Of A 90 Percent Owned Subsidiary)**

Kelowna Corporation acquires 100 percent of the shares of its subsidiary Columbia Inc. on October 31, 2009 for \$2,750,000. At that time, Columbia Inc. owned one non-depreciable asset, a piece of vacant land with an adjusted cost base of \$400,000 and a fair market value of \$750,000. Since November 1, 2009, Columbia Inc. has paid dividends of \$300,000 to Kelowna Corporation. On October 31, 2016, when the net assets of Columbia Inc. have a tax value of \$2,200,000, Columbia Inc. is wound up into Kelowna Corporation under ITA 88(1). What will be the value of the land after the wind-up?

**Exam Exercise Seventeen - 13 (Winding-Up Of A 90 Percent Owned Subsidiary)**

Nanaimo Corporation acquires 100 percent of the shares of its subsidiary Island Inc. on December 31, 2009 for \$2,750,000. At that time, Island Inc. owned one non-depreciable asset, a piece of vacant land with an adjusted cost base of \$200,000 and a fair market value of \$350,000. Since January 1, 2010, Island Inc. has paid dividends totaling \$300,000 to Nanaimo Corporation. On December 31, 2016, when the net assets of Island Inc. have a tax value of \$2,200,000, Island Inc. is wound up into Nanaimo Corporation under ITA 88(1). Nanaimo Corporation then sells the vacant land that was owned by Island Inc. for \$1,600,000. What taxable capital gain will Nanaimo report as a result of this sale?

**Exam Exercise Seventeen - 14 (Winding-Up Of A Canadian Corporation)**

Sundown Inc. is a Canadian controlled private corporation. After disposing of all of its assets and paying all of its liabilities, including Tax Payable resulting from the asset dispositions, Sundown Inc. is left with cash of \$2,854,500. The PUC of the Company's shares is equal to their adjusted cost base, an amount of \$290,400. After the sale of assets, the Company has an RDTOH account balance of \$155,100, a capital dividend account balance of \$85,800 and a GRIP balance of nil.

Determine the tax consequences to the shareholders of Sundown Inc. if, during 2016, the Company makes the maximum cash distribution to its shareholders. Assume that appropriate elections will be made to minimize the taxes that will be paid by the shareholders. You are not required to calculate personal tax payable for the shareholders.

**Exam Exercise Seventeen - 15 (Winding-Up Of A Canadian Corporation)**

Ku Jung owns all of the shares of Jay Ltd. His adjusted cost base for these shares is \$5,000. He has decided to retire, and has wound up the Company under the provisions of ITA 88(2). After the assets have been sold and all corporate taxes paid, there is \$700,000 available for distribution. The balances in the tax accounts of Jay Ltd. are as follows:

Paid Up Capital	\$ 1,000
RDTOH	20,000
GRIP Account	30,000
Capital Dividend Account	100,000

What are the tax consequences if, during 2016, the final payment is made to Mr. Jung. Assume that all elections are made to minimize the tax effect?

## **TIF PROBLEM SEVENTEEN - 5A**

### **Chapter 17 - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 17, “Other Rollovers And Sale Of An Incorporated Business”.

- A. Amalgamation
- B. Legal Stated Capital
- C. Merger
- D. Restrictive Covenant
- E. Share For Share Exchange (ITA 85.1)
- F. Subsidiary
- G. Convertible Property
- H. Winding-Up Of A 90% Owned Subsidiary

The following list contains ten potential definitions for the preceding key terms.

1. A series of transactions that result in substantially all of the assets of a Canadian corporation being distributed to the shareholders of that corporation.
2. A rollover provision that allows the assets of a 90 percent or more owned subsidiary to be combined with the assets of its parent company, without tax consequences.
3. An agreement entered into, an undertaking made, or a waiver of an advantage or right by the taxpayer.
4. A rollover provision that allows one class of shares in a corporation to be exchanged for a different class of shares, without tax consequences.
5. An amount that is specified in corporate enabling legislation.
6. A combination of two or more business enterprises.
7. A rollover provision that allows one corporation to acquire shares in another corporation by issuing its own shares, without tax consequences to either of the corporations or their shareholders.
8. A rollover provision that allows two taxable Canadian corporations to be combined into a single taxable Canadian corporation, without tax consequences.
9. A debt or equity financial instrument of a corporation that can be exchanged for a different debt or equity financial instrument of the same corporation, without the payment of additional consideration.
10. An enterprise that is controlled by another enterprise.
11. None of the above definitions apply. (This answer can be used more than once.)

**TIF Problem Seventeen - 5A**  
*Chapter 17 - Key Term Matching (Easy)*

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## TIF PROBLEM SEVENTEEN - 5B

### Chapter 17 - Key Term Matching (Moderate)

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 17, "Other Rollovers And Sale Of An Incorporated Business".

- Amalgamation
- Legal Stated Capital
- Merger
- Restrictive Covenant
- Share For Share Exchange (ITA 85.1)
- Subsidiary
- Convertible Property
- Winding-Up Of A 90% Owned Subsidiary

The following list contains 14 potential definitions for the preceding key terms.

1. A series of transactions that result in substantially all of the assets of a Canadian corporation being distributed to the shareholders of that corporation.
2. An agreement that restricts the taxpayer's ability to sell shares in a corporation for a specified period of time.
3. A rollover provision that allows the assets of a 90 percent or more owned subsidiary to be combined with the assets of its parent company, without tax consequences.
4. An agreement entered into, an undertaking made, or a waiver of an advantage or right by the taxpayer.
5. Equity securities that can be converted into a different class of equity shares, without tax consequences.
6. A rollover provision that allows one class of shares in a corporation to be exchanged for a different class of shares, without tax consequences.
7. A rollover provision that allows any two private corporations to be combined into a single taxable Canadian corporation, without tax consequences.
8. An amount that is specified in corporate enabling legislation.
9. A combination of two or more business enterprises.
10. A rollover provision that allows one corporation to acquire shares in another corporation by issuing its own shares, without tax consequences to either of the corporations or their shareholders.
11. A rollover provision that allows two taxable Canadian corporations to be combined into a single taxable Canadian corporation, without tax consequences.

12. A debt or equity financial instrument of a corporation that can be exchanged for a different debt or equity financial instrument of the same corporation, without the payment of additional consideration.
13. A rollover provision that allows the assets of a 90 percent owned subsidiary to be transferred to its parent and minority shareholders, without tax consequences.
14. An enterprise that is controlled by another enterprise.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM SEVENTEEN - 6**

### **Section 85.1 Share For Share Exchange**

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In 2008, Jerry Boseman opened a retail business 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 two or three years. As he was employed at this time, he planned to use the losses to offset his employment income.

As the business had become profitable by the end of 2011, he decides to incorporate. The new corporation will be called Jerry's Flowers Ltd. and will have a December 31 year end.

On January 1, 2012, the following values were established for the assets of the business:

Tax Values Of The Business Assets	\$ 986,000
Fair Market Value Of The Business Assets	\$2,340,000

On this date, these assets are transferred to the corporation under the provisions of ITA 85(1) at a total elected value of \$986,000. As consideration, Jerry receives a note for \$500,000, along with 1,000 Jerry's Flowers Ltd. shares with a market value of \$1,840 each. No other shares were issued by the corporation.

On January 1, 2016, he receives an offer from Large Flowers Inc. to acquire all of his Jerry's Flowers Ltd. shares. As consideration, he would receive 50,000 Large Flowers Inc. shares. These shares are currently trading at \$75 per share. Jerry is at arm's length with Large Flowers Inc. and will remain so subsequent to the exchange of shares. Jerry's Flowers Ltd. is not a qualified small business corporation.

Jerry has an \$800,000 net capital loss carry forward resulting from a "hot" stock tip from his wife at the time (now ex-wife).

**Required:**

- A. Advise Jerry with respect to the tax consequences that would arise for him from accepting the Large Flowers Ltd. offer. Your answer should consider both the application of ITA 85.1 and opting out of this provision.
- B. Indicate the adjusted cost base of the Jerry's Flowers shares in the hands of Large Flowers Inc.
- C. Advise Jerry as to the alternative approaches that might simultaneously make use of his net capital loss carry forward and minimize his current payment of taxes.

## **TIF PROBLEM SEVENTEEN - 7**

### **Section 86(1) Share Exchange**

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Mimi Farrow is the founder and sole shareholder of Farrow Ltd. Her initial and only investment was \$600,000 in return for all 6,000 of the Company's common shares. This figure represents both the PUC and the adjusted cost base of these shares. The Company has a December 31 year end and has enjoyed a high level of profits since its first year of operations.

On August 1, 2016, the condensed Balance Sheet of the business is as follows:

**Farrow Ltd.**  
**Balance Sheet**  
**As At August 1, 2016**

Tangible Assets (Tax Values)	\$11,625,000
Bank Loan	\$ 1,112,000
Common Stock (No Par - 6,000 Shares)	600,000
Retained Earnings	9,913,000
Total Debt And Shareholders' Equity	\$11,625,000

An independent appraiser has indicated that the fair market value of the tangible assets of the business are equal to their tax values. In addition to tangible assets, the appraiser indicates that the business has \$1,500,000 of goodwill.

Ms. Farrow has contacted you with respect to transferring future growth in Farrow Ltd. to her 23 year old son, Woody. However, for at least a few years, she would like to retain control of the operations of the business. She has also indicated that, while she thinks Woody has great future potential as a director of movies based on his intense feelings of anxiety and dread, he has not enjoyed any financial success to date. Given this, he would only be able to invest \$5,000 in the corporation at this time.

She has heard of a procedure called an exchange of shares in a reorganization that would allow her to transfer future growth in Farrow Ltd. to Woody without any immediate tax consequences. She has asked for your advice in this matter.

**Required:** Advise Ms. Farrow. Include in your solution the August 1, 2016 Balance Sheet after your proposed share transactions.

## **TIF PROBLEM SEVENTEEN - 8**

### **ITA 85(1) and ITA 86(1) Share Exchange**

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Marian Soft opened an unincorporated software business in 2006. The business, known as Home Software, operated successfully for a number of years, becoming sufficiently profitable that Marian no longer needed all of the income that was being produced by the business. Given this, she was advised that she could defer a significant amount of taxes by incorporating her business and that she could avoid taxation at the time of incorporation by using ITA 85(1).

On January 1, 2011, the assets of the business have tax values totalling \$1,373,000 and fair market values estimated to total \$1,650,000. On this date the assets are transferred to a new corporation, Home Software Inc., at an elected value of \$1,373,000. As consideration, Marian takes back a note payable for \$1,000,000 and common shares with a fair market value of \$650,000. The new Company will have a December 31 year end.

The business continues to operate very successfully and, on January 1, 2016, the assets of the business have tax values of \$5,263,000. The fair market value of these assets is \$6,406,000.

In recent years, Marian's adult son Jeff has been actively involved in running the business. This fact, along with the desire to retire from the business in a few years, has led her to decide to transfer the future growth of the business to Jeff. After consultation with her tax adviser, she is going to exchange her common shares in Home Software Inc. for \$906,000 in cash and redeemable preferred shares with a fair market value of \$5,500,000. Subsequent to this exchange, her son Jeff will invest \$10,000 for new common shares in Home Software Inc.

Home Software Inc. does not have a GRIP balance or an RDTOH balance on January 1, 2016.

**Required:**

- A. Determine the tax consequences for Marian that will result from her exchange of shares. As part of your answer, you should indicate both the adjusted cost base and the PUC of her preferred shares.
- B. Determine the tax consequences for Marian that would result from the redemption of her preferred shares on February 1, 2016 for their fair market value of \$5,500,000.

## **TIF PROBLEM SEVENTEEN - 9**

### **Section 86 Reorganization With Gift**

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Nome Industries was founded in 2008 with the issuance of 15,000 common shares for \$60 per share in cash to Gnancy Gnome. No additional shares have been issued since the inception of the Company.

In 2010, Derek Blume and his son, James acquired all of the shares at a price of \$85 per share from Ms. Gnome. Derek acquired 12,000 of the shares, while James acquired the remaining 3,000.

On January 1, 2016, the fair market value of the Nome shares is \$1,500,000 (\$100 per share). The Company is not a qualified small business corporation and it has a nil balance in its General Rate Income Pool (GRIP) account for all years under consideration.

Derek has been diagnosed with lung cancer. Given the high probability of a limited life expectancy, he would like to freeze the value of his shares at their January 1, 2016 fair market value. To accomplish this, he intends to exchange his 12,000 common shares for cash of \$200,000 and 8,000 preferred shares with a legal stated capital and a redemption value of \$800,000. Subsequent to this transaction, his son James will own all of the outstanding common shares of Nome Industries.

**Required:**

- A. Describe the immediate tax consequences of this transaction to Derek Blume, including the following:
  - the amount of any gift that Derek has made to James;
  - the PUC of the new preferred shares;
  - the adjusted cost base for the new preferred shares;
  - the amount of any deemed dividends arising on the exchange; and
  - any capital gain or loss resulting from the exchange of the common shares.
- B. Describe the tax consequences of this transaction to James.
- C. Describe the tax consequences of this transaction to Derek Blume, if the new preferred shares in Nome Ltd. were redeemed at their fair market value of \$800,000 during 2016.

## **TIF PROBLEM SEVENTEEN - 10**

### **Section 86 Reorganization**

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Espana Ltd. was incorporated with an initial investment of \$465,000 in cash. In return for this investment, Ms. Portia Cruz received common shares with a fair market value and a paid up capital of \$465,000.

In 2011, Mr. Jose Martinez acquired all of Ms. Cruz's shares in return for a payment of \$1,340,000. As there was no additional investment in Espana Ltd. subsequent to its incorporation, Mr. Martinez became the sole shareholder of the Company at this point in time.

Under Mr. Martinez's direction, the Company continued to prosper, with the fair market value of the shares on December 1, 2016 estimated to be \$3,500,000.

As he is nearly 70 years of age, Mr. Martinez would like to freeze the value of his holding of Espana Ltd. shares. To accomplish this, on December 1, 2016, he sells 25 percent of his shares to his 42 year old daughter for cash of \$875,000 [(25%)( $\$3,500,000$ )]. Also on this date, he exchanges the remaining 75 percent of the common shares for cash of \$625,000, plus redeemable preferred shares with a fair market value and legal stated capital of \$2,000,000.

Espana Ltd. is not a qualified small business corporation. The Company has a nil balance in its General Rate Income Pool (GRIP) account for all years under consideration.

**Required:** Determine the following:

- A. The amount of the gift to a related party, if any, resulting from the exchange of shares.
- B. The paid up capital of the newly issued preferred shares.
- C. The adjusted cost base of the newly issued preferred shares.
- D. The proceeds of redemption/disposition that Mr. Martinez received when he exchanged the old common shares of Espana Ltd. for preferred shares.
- E. The immediate tax consequences for Mr. Martinez resulting from the sale of shares to his daughter and the exchange of shares.
- F. The tax consequences for Mr. Martinez if the new Espana Ltd. preferred shares are immediately redeemed for their fair market value.

## **TIF PROBLEM SEVENTEEN - 11**

### **Winding-Up Of A Corporation**

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Due to his advanced age, Gordon Korngold, the only shareholder of Korngold Ltd., has decided to retire. As the Company activities are largely based on Gordon's effort, he intends to sell the assets of the company, followed by a wind-up and distribution of the resulting cash.

Korngold Ltd. is a CCPC with a December 31 taxation year end. In contemplation of this liquidation, a Balance Sheet has been prepared based on the tax values of its assets and liabilities as at January 1, 2016. This Balance Sheet, after all closing entries, is as follows:

<b>Korngold Ltd.</b>	
<b>Balance Sheet</b>	
<b>As At January 1, 2016</b>	
Inventories (Net Realizable Value And Tax Cost)	\$ 48,650
Refundable Dividend Tax On Hand	32,345
Land - Adjusted Cost Base	942,450
Building - Undepreciated Capital Cost	723,640
<b>Total Assets</b>	<b>\$1,747,085</b>
<hr/>	
Liabilities	\$ 313,260
Paid Up Capital	625,000
Capital Dividend Account	326,470
Other Income Retained	482,355
<b>Total Equities</b>	<b>\$1,747,085</b>

#### **Other Information:**

1. The current fair market value of the Land is \$2,600,000.
2. The Building had an capital cost of \$1,160,000. Its fair market value on January 1, 2016 is \$1,846,000.
3. The adjusted cost base of the common shares is equal to \$625,000, their paid up capital.
4. On January 1, 2016, the Company has a nil balance in its General Rate Income Pool (GRIP) account.
5. All of the assets are disposed of on January 1, 2016 at their fair market values. The corporation's liabilities are also paid on this date. The after tax proceeds from the sale are distributed to shareholders on January 15, 2016.
6. The provincial tax rate for the corporation on income that qualifies for the small business deduction is 3 percent. On all other income, the provincial rate is 14 percent.
7. No dividends have been paid in the previous two years.

#### **Required:**

- A. Calculate the amount that will be available for distribution to Mr. Korngold after the liquidation.
- B. Determine the components of the distribution to Mr. Korngold, and the amount of taxable capital gains that will accrue to him as a result of the winding-up of Korngold Ltd. Assume that appropriate elections or designations will be made to minimize the taxes that will be paid by Mr. Korngold.

**TIF PROBLEM SEVENTEEN - 12****Sale Of Assets**

Pellerin Fabrication Ltd. is a Canadian controlled private corporation with a June 30 year end. All of the shares of the corporation are owned by Mr. Denis Pellerin, the founder of the corporation. On June 30, 2016, the Balance Sheet of the Company, after all closing entries and prepared in accordance with generally accepted accounting principles, is as follows:

Cash	\$ 50,000
Accounts Receivable	215,000
Inventories (Lower Of Cost And Market)	375,000
Land (Cost)	132,000
Building (Cost)	850,000
Accumulated Amortization	( 263,000)
<b>Total Assets</b>	<b>\$1,359,000</b>
<hr/>	
Liabilities	\$ 373,000
Common Stock - No Par	600,000
Retained Earnings	386,000
<b>Total Equities</b>	<b>\$1,359,000</b>

Mr. Pellerin wishes to retire and has agreed to sell all of the non-cash assets of the business, including goodwill, at their fair market values on July 1, 2016. The buyer will assume all of the liabilities of the corporation and will pay the purchase price in cash. The relevant fair market values and the resulting purchase prices are as follows:

Accounts Receivable	\$195,000
Inventories	375,000
Land	193,875
Building	550,000
Goodwill	56,250
Liabilities	( 386,125)
<b>Purchase Price</b>	<b>\$984,000</b>

**Other Information:**

1. With respect to the transfer of the Accounts Receivable, the appropriate election is made under ITA 22.
2. The UCC of the Building is \$492,000.
3. As at June 30, 2016, the corporation has a balance in its Refundable Dividend Tax On Hand account of \$31,000. No dividends were paid during the previous year ending June 30, 2015.
4. As at June 30, 2016, the capital dividend account has a balance of \$63,000 and there is a nil balance in the General Rate Income Pool (GRIP) account.
5. The PUC of the corporation is equal to the account balance for the Common Stock. This is also Mr. Pellerin's adjusted cost base for the shares.
6. The corporation is subject to a provincial tax rate of 3 percent on income eligible for the federal small business deduction and 13 percent on other income.

7. For 2016, Mr. Pellerin will have income from other sources in excess of \$300,000. This means his marginal income is taxed at a 33 percent rate at the federal level and a 16 percent rate at the provincial level. The provincial dividend tax credit for non-eligible dividends is equal to  $\frac{8}{29}$  of the gross up.
8. Pellerin Fabrication Ltd. is not a qualified small business corporation.

**Required:**

- A. Calculate the after corporate tax amount that will be available for distribution to Mr. Pellerin after the asset sale.
- B. Calculate the amount that will be available to Mr. Pellerin, after personal taxes are paid, on the distribution of the funds resulting from the winding-up of Pellerin Fabrication Ltd. Assume that appropriate elections and designations will be made to minimize the taxes that will be paid by Mr. Pellerin.

**TIF PROBLEM SEVENTEEN - 13****Sale Of Assets vs. Shares**

Mr. David Carson is the president and only shareholder of Carson Enterprises Ltd., a Canadian controlled private corporation. The Company's fiscal year ends on December 31. Mr. Carson established the Company 15 years ago by investing \$265,000 in cash. There have been no other shares issued since then.

Mr. Carson is considering selling the corporation and, in order to better evaluate this possibility, he has prepared a special Statement Of Assets. In this special statement, comparative disclosure is provided for the values included in his accounting records, values that are relevant for tax purposes, and fair market values. This statement is as follows:

**Carson Enterprises Ltd.  
Statement Of Assets  
As At January 1, 2016**

	Accounting Net Book Value	Tax Value	Fair Market Value
Cash	\$ 54,500	\$ 54,500	\$ 54,500
Accounts Receivable	406,000	406,000	372,250
Inventories	869,750	869,750	976,000
Land	201,500	201,500	405,000
Building (Note One)	538,000	469,250	2,061,000
Equipment (Note Two)	434,000	294,000	171,250
Goodwill	Nil	Nil	811,000
Totals	\$2,503,750	\$2,295,000	\$4,851,000

**Note One** Mr. Carson built this Building on the Land for a total cost of \$1,281,000.

**Note Two** The Equipment had a cost of \$807,500.

At the same time that this Statement Of Assets was prepared, a similar Statement Of Equities was drawn up. This latter statement contained the following accounting and tax values:

	Accounting Book Value	Tax Value
Current Liabilities	\$ 697,000	\$ 697,000
Loan From Shareholder	137,500	137,500
Future Income Tax Liability	542,000	N/A
Common Stock - No Par	265,000	265,000
Capital Dividend Account	N/A	164,500
Other Income Retained	N/A	1,031,000
Retained Earnings	862,250	N/A
Totals	\$2,503,750	\$2,295,000

In addition to the information included in the preceding statements, the following other information about the Company is available:

- The Company has available non-capital loss carry forwards of \$83,000.
- The Company has available a net capital loss carry forward of \$129,650 [(1/2)(\$259,300)].

- Carson Enterprises Ltd. is subject to a provincial tax rate of 3 percent on income that qualifies for the federal small business deduction and 14 percent on income that does not qualify for this deduction.
- On December 31, 2015, the Company has no balance in either its RDTOH account or its General Rate Income Pool (GRIP) account.
- Carson Enterprises Ltd. is not a qualified small business corporation.

Mr. Carson has received two offers for his Company, and he plans to accept one of them on January 2, 2016. The first offer involves a cash payment of \$3,508,000 in return for all of the shares of the Company. Alternatively, another investor has expressed a willingness to acquire all of the assets, including goodwill, at a price equal to their fair market values. This investor would assume all of the liabilities of the corporation and has agreed to file an ITA 22 election with respect to the Accounts Receivable. If the assets are sold, it is Mr. Carson's intention to wind up the corporation.

Mr. Carson will have over \$300,000 in income from other sources and, as a consequence, any income that arises on the disposition of this business will be taxed at the maximum federal rate of 33 percent, combined with a provincial rate of 18 percent. He lives in a province where the provincial dividend tax credit on eligible dividends is 5/11 of the gross up, and on non-eligible dividends is equal to 8/29 of the gross up.

**Required:** Determine which of the two offers Mr. Carson should accept. Ignore the possibility that Mr. Carson might be subject to the alternative minimum tax. Assume that appropriate elections or designations will be made to minimize the taxes that will be paid by Mr. Carson.

## **Chapter Eighteen Test Item File Problems**

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### **TIF PROBLEM EIGHTEEN - 1**

#### **Partnerships - Essay Questions**

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1. Under the provisions of the *Income Tax Act*, only individuals, corporations, and trusts are considered to be taxable entities. Given this, explain how the business income, capital gains, and property income earned by a partnership will be taxed.
2. Briefly describe the three basic elements that are required in the formation of a partnership.
3. Mr. Johns, Mr. Klien, and Ms. Langley are all Chartered Professional Accountants who trained in large national firms. However, for the last few years they have each operated a small private practice. They are currently discussing the possibility of forming a partnership to combine their practices. List four major points to be considered in the formation of such a partnership and in drawing up a partnership agreement.
4. The degree to which partners have responsibility for partnership debts depends on the type of partnership. In terms of this responsibility, briefly describe the three types of partnerships that are discussed in your text.
5. Describe three factors that have been used to distinguish joint venture arrangements from partnership arrangements.
6. What is the basic difference between the tax procedures applicable to joint ventures and the tax procedures applicable to partnerships?
7. What are the rules for determining the taxation year of a partnership?
8. CCA can only be taken on property that is owned by the taxpayer. As a partnership is not a legal entity, it cannot own property. Does this mean that a partnership cannot deduct CCA in determining its income? Explain your conclusion.
9. The various types of income earned in a partnership retain their tax characteristics when allocated to the partners. Explain this statement.
10. In determining the Net Business Income (for tax purposes) of a partnership, how are salaries to the partners dealt with?
11. In converting accounting business income to Net Business Income (for tax purposes), is there a need to make an adjustment for drawings?
12. Partnership organizations sometimes make donations to registered charities. How are these amounts dealt with in the determination of Net Business Income (for tax purposes) at the partnership level?
13. A member of a partnership, because of losses on other investments, would like to maximize his partnership income. To this end, he has asked that no CCA be deducted from his share of the partnership income. Should the other partners agree to this request?
14. Describe the treatment of capital gains in the conversion of accounting net income to Net Business Income (for tax purposes) of a partnership.
15. If the partnership agreement does not specify how profits will be shared, how will the profit allocation be determined?

16. An individual wishes to become a member of an existing partnership. What are this individual's alternatives for acquiring this interest?
17. In determining the adjusted cost base of a partnership interest, briefly describe the treatment of each of the following items:
  - capital contributions,
  - partner's share of partnership Net Business Income, and
  - partner's drawings.
18. Describe the treatment of partnership capital gains in the determination of a partner's Net Income For Tax Purposes and the adjusted cost base on his partnership interest.
19. Describe the treatment of partnership taxable dividends received in the determination of a partner's Net Income For Tax Purposes and the adjusted cost base on his partnership interest. The partner is an individual.
20. Adjustments to the adjusted cost base of a partnership interest can sometimes result in a "negative" amount. What are the tax consequences of this to the partner?
21. What is a limited partnership? Your answer should include the meaning of "limited partner".
22. What is the objective of the "at-risk" rules that are applicable to limited partnerships?
23. What is a "Canadian Partnership"? In terms of tax legislation, what is the importance of qualifying as a Canadian Partnership?
24. Briefly describe the procedures required to incorporate a partnership without incurring any current Tax Payable.

## **TIF PROBLEM EIGHTEEN - 2**

### **Partnerships - True Or False**

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#### ***New For 2016/2017***

1. A partnership is not a taxable entity, either for income tax purposes or for GST/HST purposes.  

True or False?
2. From the point of view of determining an individual's Tax Payable, it does not matter whether he is considered a partner or a joint venturer.  

True or False?
3. If all of the members of a partnership are individuals, the partnership can use a non-calendar taxation year.  

True or False?
4. When dividends received by a partnership are allocated to individual partners, these partners will gross up the amount received and be eligible for a dividend tax credit.  

True or False?
5. If a partnership pays interest to partners on their average capital contributions, the payments can be deducted in determining the net business income of the partnership.  

True or False?
6. If a partnership sells a depreciable asset and, as a result of the disposition, recapture is recorded, this will be included in the net business income that is allocated to the partners.  

True or False?
7. Only one-half of any partnership capital gains that are allocated to partners will be added to the partner's adjusted cost base.  

True or False?
8. When a partner is allocated political contributions made by the partnership, the amount will be deducted from the adjusted cost base of that partner.  

True or False?
9. In determining the at-risk amount for a partner, positive amounts of partnership income allocations for the year are added to the opening balance of the partner's adjusted cost base.  

True or False?
10. When a capital property is transferred from an existing partnership to a new partnership, any capital gain or recapture from the disposition will be recorded as income of the existing partnership.  

True or False?

#### ***Retained From Previous Editions***

11. Income that is flowed through a partnership into the hands of the partners will retain its tax characteristics (e.g., the partnership's capital gains will be passed to the partners as capital gains).  

True or False?

**TIF Problem Eighteen - 2**  
*Partnerships - True Or False*

12. While only one-half of partnership capital gains will be included in the Net Income For Tax Purposes of a partner, 100 percent of such gains will be added to the adjusted cost base of the partner's partnership interest.

True or False?

13. In computing a partnership's Net Business Income (for tax purposes), salaries paid to the partners can only be deducted if they are reasonable.

True or False?

14. In computing a partnership's Net Business Income (for tax purposes), the amount of CCA to be deducted would be calculated using the same rules that are applicable to a corporation.

True or False?

15. In computing a partnership's Net Business Income (for tax purposes), charitable donations made by the partnership should be deducted.

True or False?

## TIF PROBLEM EIGHTEEN - 3

### Partnerships - Multiple Choice

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#### New For 2016/2017

##### **Partnership Characteristics**

1. Which of the following statements is correct with respect to partnerships?
  - A. At least one of the partners must be an individual.
  - B. Limited partners cannot participate in the management of the partnership.
  - C. Partnerships are not required to have an expectation of profit.
  - D. The use of the partnership form of business will allow the partners to pay higher salaries to family members.

##### **Co-Ownership, Joint Ventures and Syndicates**

2. Which of the following statements regarding partnerships and joint ventures is correct?
  - A. Joint ventures are taxable entities for both income tax and GST/HST purposes.
  - B. Both partners and joint venturers have the ability to contractually bind other partners and joint venturers.
  - C. For both partnerships and joint ventures, all participants must use the same CCA figure for the current year.
  - D. Partners share the profit of the partnership and joint venturers share the gross revenues of the joint venture.

##### **Partnership Income, Losses And Tax Credits**

3. Jacques is a member of a partnership that had a Net Business Income for tax purposes of \$456,000 during the current year. His share of this income is \$228,000. During this year, Jacques received monthly salary from the partnership that totalled \$156,000 for the year. At the end of the year, the partnership distributed bonuses of \$90,000 to each of the partners. How much income from the partnership should Jacques report for the current year?
  - A. \$156,000.
  - B. \$228,000.
  - C. \$246,000.
  - D. \$474,000.

##### **Partnership Interest**

4. Christine would like to calculate the adjusted cost base of her partnership interest. She should include all of the following factors in her calculations except:
  - A. Her share of the capital gains which the partnership realized during the year.
  - B. Her share of the political contributions made during the year by the partnership.
  - C. Her share of the business loss that accrued to the partnership during the year.
  - D. Her share of the dividend gross up on dividends received by the partnership during the year.

##### **Limited Partnerships and Limited Partners**

5. On January 1, 2016, Barry Score acquires a 25 percent interest in a limited partnership for \$200,000. Barry pays an immediate deposit of \$50,000 with the balance due in 2018. For the year ending December 31, 2016, the partnership determines that it has a \$40,000 capital gain and a \$100,000 business loss. What is Barry's at-risk amount?
  - A. \$30,000.
  - B. \$200,000.
  - C. \$60,000.
  - D. \$55,000.

**Transfer of Property To And From A Partnership**

6. Arnold is a partner in the Polar Partnership. He has some vacant land that is in a perfect location for a building the partnership wants to construct. He transfers the land to the partnership in exchange for \$155,000 in cash. The land cost him \$95,000 and has a fair market value of \$140,000. What is the effect on the adjusted cost base of his partnership interest?
- A. An increase of \$155,000.
  - B. A decrease of \$15,000.
  - C. An increase of \$15,000.
  - D. A decrease of \$60,000.

**Retained From Previous Editions**

**Partnership Characteristics**

7. Which of the following is **NOT** a basic feature required to create a partnership?
- A. One of the partners must be an individual.
  - B. There must be two or more persons involved.
  - C. The persons must be carrying on a business.
  - D. The business must be carried on with an expectation of a profit.
8. Which of the following statements about limited partners is **NOT** correct?
- A. They are entitled to share equally in profits and losses, unless there is an agreement to the contrary.
  - B. They are jointly and severally liable for partnership debt and wrongful acts of other partners.
  - C. They are not responsible for the wrongful acts of other partners, except to the extent of their actual and promised contributions to the partnership.
  - D. Property that they contribute to the partnership is considered partnership property.
9. Which of the following statements is **NOT** correct with respect to partnerships?
- A. General partners are entitled to participate in the management of the company.
  - B. General partners are a separate legal entity from the business.
  - C. Unless the partnership agreement states otherwise, general partners are entitled to an equal share of the profits of the business.
  - D. General partners are jointly and severally liable for the debts of the company.
10. What advantage is offered by a general partnership, as compared to a corporation, as a form of business organization?
- A. Partners may be able to reduce their personal income taxes if the business has losses in the start-up years.
  - B. Higher salaries can be paid to family members and claimed as an expense.
  - C. Creditors cannot seize a partner's personal assets to cover business obligations.
  - D. Partners will be able to defer taxes on income that is left within the partnership.

11. Jesse and Harold decide to form a partnership. They believe that this arrangement will have the following advantages:
1. They may be able to reduce their personal income taxes during the start-up years.
  2. They may be able to split income with family members who are employed by the business.
  3. They may be able to realize a tax deferral on their business income.
  4. They will have limited personal liability for the debts of the business.
- All of these statements are correct except:
- A. 1 and 3.
  - B. 2 only.
  - C. 3 and 4.
  - D. 1 and 2.

***Co-Ownership, Joint Ventures and Syndicates***

12. The distinguishing factor that makes an arrangement a co-ownership as opposed to a partnership would be:
- A. When profits or losses are accounted for individually.
  - B. When profits or losses are split equally.
  - C. When participants do not have the power to bind other participants.
  - D. When gross revenue is shared, rather than profits.
13. A joint venture might be recognized because it would demonstrate one of the following factors. Which one?
- A. The joint venture will own all property that co-venturers have contributed to the venture.
  - B. Co-venturers are jointly and severally liable for activities of the undertaking.
  - C. Co-venturers share profits not gross revenues.
  - D. Co-venturers do not have the power to bind other co-venturers contractually.
14. A group of unrelated insurance companies combine forces to underwrite a very high-risk insurance policy. What type of arrangement would this collaboration be most likely to be?
- A. A partnership.
  - B. A co-ownership.
  - C. A joint venture.
  - D. A syndicate.

***Partnership Income, Losses And Tax Credits***

15. Martin Aggerwal has a 30 percent interest in a partnership. During the current year, the partnership realized capital gains of \$42,000, received non-eligible dividends of \$15,000, and made charitable donations of \$6,000. Martin is not eligible for the first-time donor's super credit and has made no charitable donations personally. He has no income that will be taxed at 33 percent at the federal level. Which of the following statements is correct?
- A. Martin will report taxable capital gains of \$6,300, will have a federal dividend tax credit of \$554, and a charitable donations tax credit of \$494.
  - B. Martin will report taxable capital gains of \$12,600, will have a federal dividend tax credit of \$554, and a charitable donations tax credit of \$522.
  - C. Martin will report taxable capital gains of \$6,300, will have a federal dividend tax credit of \$765, and a charitable donations tax credit of \$494.
  - D. Martin will report taxable capital gains of \$6,300, will have a federal dividend tax credit of \$554, and a charitable donations tax credit of \$522.

16. The Bartlo Partnership has income for the year ending December 31, 2016 of \$490,000. As per the partnership agreement, this amount has been determined under generally accepted accounting principles. The agreement also calls for each of the two partners to have an equal share in this income. The following amounts are included in the calculation of this income figure:

- Non-eligible dividends received of \$32,000
- Gains on the sale of shares of \$96,000
- Charitable donations of \$12,000
- Amortization on equipment of \$49,000 (equal to CCA)

The two partners will each have Taxable Income for the 2016 taxation year of:

- A. \$227,000.
- B. \$223,720.
- C. \$229,720.
- D. \$245,000.

17. The Keisha Partnership has determined that business income for the 2016 taxation year was \$130,000. Ms. Kerry holds a 50% interest in the partnership. Her drawings from the partnership during 2016 totalled \$45,000. In addition, Ms. Kerry has made the following business related expenditures from her own funds outside the partnership: meals and entertainment costs of \$5,000; business related automobile costs of \$3,500; charitable donations of \$3,000. How much business income will Ms. Kerry report on her 2016 tax return?

- A. \$45,000
- B. \$56,000
- C. \$59,000
- D. \$65,000

18. Mr. Poulet is a partner in a partnership with a December 31 year end. Mr. Poulet's share of the partnership allocations for 2016 are as follows:

- business income of \$120,000
- charitable donations of \$1,500
- partnership draws totalling \$100,000

Mr. Poulet's partnership interest had an adjusted cost base on January 1, 2016 of \$222,000. What is the adjusted cost base on January 1, 2017?

- A. \$120,500
- B. \$240,500
- C. \$242,000
- D. \$243,500

19. Which one of the following statements related to partnerships is **NOT** correct?

- A. Dividends received by a partnership are not grossed up by the partnership in the calculation of partnership income.
- B. Charitable donations made by a partnership are not deductible by the partnership.
- C. Business losses of a partnership cannot be allocated to the partners for them to deduct against other sources of income.
- D. Salaries to partners are not deductible by the partnership in the computation of partnership income.

**Partnership Interest**

20. Joe Conners is a member of a partnership with a December 31 year end. Joe's share of the 2016 partnership allocations was as follows:

- Net Business Loss For Tax Purposes of \$25,000.
- Charitable Donations of \$1,000.

Joe took drawings totalling \$10,000 from the partnership during 2016. Joe's adjusted cost base (ACB) at January 1, 2016 was \$59,000. What is the ACB of Joe's partnership interest at January 1, 2017?

- A. \$23,000.
- B. \$24,000.
- C. \$25,000.
- D. \$33,000.

21. Ms. Sarah McLean has a 50 percent interest in a partnership that was acquired on January 1, 2016 at a cost of \$40,000. The partnership's Net Business Income (for tax purposes) for the taxation year ending December 31, 2016 was \$50,000, a figure that included a CCA deduction of \$36,000. The 2016 Net Business Income figure did not include taxable capital gains of \$10,000 realized by the partnership. During 2016, Ms. McLean withdrew \$15,000 from the partnership. The adjusted cost base of Ms. McLean's partnership interest at January 1, 2017 is:

- A. \$55,000.
- B. \$88,000.
- C. \$50,000.
- D. \$60,000.

22. Femi and Fola are sisters who are partners in the Double F Partnership, each holding a 50 percent interest. They wish to bring their brother, Faraji into the partnership on January 1, 2016, with a 20% interest. Faraji will pay \$15,000 to each of his sisters in order to purchase 20% of each of their 50% interests. On January 1, 2016, Femi and Fola each have capital accounts with a balance of \$50,000, which is equal to their adjusted cost base. Which of the following statements describes the tax consequences to Femi and Fola of admitting their brother to the partnership?

- A. Each sister will have a taxable capital gain of \$2,500.
- B. Each sister will have their capital account balance and adjusted cost base reduced to \$35,000.
- C. Each sister will have a taxable capital gain of \$7,500.
- D. There will be no tax consequences to the two sisters.

23. Jabari becomes a 40% interest partner in an accounting partnership on January 1, 2016. During the year ended December 31, 2016, the business earns income of \$200,000 for accounting purposes. In arriving at this income figure, the bookkeeper deducted meals and entertainment costs of \$20,000, and a charitable donation of \$5,000. Jabari withdraws \$50,000 from the partnership during 2016. As of January 1, 2017, his adjusted cost base will have increased by:

- A. \$30,000.
- B. \$36,000.
- C. \$34,000.
- D. \$24,000.

24. Kasinda is a partner in Twins Partnership. At January 1, 2016, her 25% partnership interest has an adjusted cost base of \$35,000. During 2016, she withdraws \$85,000 from the partnership. During 2016, the partnership has business income for tax purposes of \$400,000. What is her adjusted cost base on December 31, 2016, and what tax consequences will result from the transactions during the year?
- A. The adjusted cost base on December 31, 2016 is nil. Because Kasinda has withdrawn more than her adjusted cost base from the partnership, she will report a taxable capital gain of \$25,000. Her partnership business income is \$100,000.
  - B. The adjusted cost base on December 31, 2016 is \$50,000. Kasinda will report partnership business income of \$100,000.
  - C. The adjusted cost base on December 31, 2016 is nil. Kasinda will report partnership business income of \$100,000.
  - D. The adjusted cost base on December 31, 2016 is negative \$50,000. Because Kasinda has withdrawn more than her adjusted cost base from the partnership, she will report partnership business income of \$50,000.
25. Red Bush and Green Tree are equal partners in Arbor Partnership. Each partner has contributed capital of \$60,000 to the partnership and this is also their adjusted cost base for the partnership interest. Blue Grass will join the partnership as an equal partner. Which of the following statements is correct?
- A. Blue Grass will pay \$20,000 directly to each of the original partners and the adjusted cost base of the partnership interest of Red Bush and Green Tree will decrease by \$20,000 each.
  - B. Blue Grass will pay \$30,000 directly to each of the original partners and the adjusted cost base of the partnership interest of Red Bush and Green Tree will decrease by \$30,000 each.
  - C. Blue Grass will pay \$40,000 directly to the partnership and the adjusted cost base of the partnership interest of Red Bush and Green Tree will increase by \$20,000 each.
  - D. Blue Grass will pay \$40,000 directly to the partnership and the adjusted cost base of the partnership interest of Red Bush and Green Tree will decrease by \$20,000 each.
26. Red Bush and Green Tree are equal partners in Arbor Partnership. Each partner has contributed capital of \$60,000 to the partnership and this is also their adjusted cost base for the partnership interest. Blue Grass wants to join the partnership as an equal partner. Both Red Bush and Green Tree have capital losses and would like to generate a capital gain from the admission of Blue Grass. Which of the following alternatives will accomplish both objectives?
- A. Blue Grass pays \$20,000 directly to both of the original partners.
  - B. Blue Grass pays \$30,000 directly to both of the original partners.
  - C. Blue Grass pays \$40,000 directly to the partnership.
  - D. Blue Grass pays \$60,000 directly to the partnership.
27. A partnership interest was sold for \$65,000. The adjusted cost base of the partnership interest was negative \$8,000. Expenses of disposition were \$2,000. What is the taxable capital gain realized on the sale?
- A. \$27,500
  - B. \$34,500
  - C. \$35,500
  - D. \$36,500

28. Which one of the following items does **NOT** affect the calculation of the adjusted cost base of a partnership interest?
- A. The non-allowable portion of a capital loss on the sale of a partnership asset.
  - B. Dividends received by the partnership.
  - C. Interest on funds borrowed by a partner to make a capital contribution.
  - D. A charitable donation made by the partnership.

**Limited Partnerships and Limited Partners**

29. Which of the following partners is **NOT** a limited partner?
- A. Mayumi, a partner in an engineering firm, entitled to 50% of the profits and responsible for 50% of losses.
  - B. Guan, a partner in an accounting firm with a guarantee that his partnership interest will be purchased by the other partners for a guaranteed minimum price of \$150,000.
  - C. Ekatarina, a partner in a law firm who is only responsible for the first \$50,000 of partnership losses.
  - D. Danyal, a partner in a construction company, who is reimbursed for any partnership losses by one of the other partners.
30. Which of the following statements best reflects the objective of the at-risk rules?
- A. The objective of the rules is to encourage investment in high-risk ventures.
  - B. The objective of the rules is to prevent taxpayers from receiving tax deductions or tax credits in excess of the amount that they are in a position to lose on their investment.
  - C. The objective of the rules is to protect investors from the losses they can incur on their investments in high risk partnerships.
  - D. The objective of the rules is to discourage investment in high-risk ventures.
31. With respect to limited partnerships, the purpose of the at-risk rules is:
- A. To ensure that the general partner is protected from putting all assets at-risk to cover partnership losses.
  - B. To ensure that general partners will have the ability to obtain financing from limited liability investors by ensuring limited liability investors know how much is at-risk.
  - C. To ensure that the tax deductions available to limited partners do not exceed the amount they have at-risk.
  - D. To ensure that the tax deductions available to limited partners are sufficient to reward investors for putting their funds at-risk.
32. What restrictions apply to a limited partnership loss?
- A. It can be carried forward for 5 years, and back for 3 years, and can be used against any type of income.
  - B. It has an indefinite carry forward period, cannot be carried back, and can only be used against limited partnership income from the same limited partnership.
  - C. It can be carried forward indefinitely, and back for 3 years, and can only be used against limited partnership income from the same limited partnership.
  - D. It has an indefinite carry forward period, cannot be carried back, and can only be used against partnership income.

33. A wealthy individual invests \$250,000 in a limited partnership. The partnership is doing research in a new medical field and will have large losses for at least 3 years. It is a high risk investment as the research may completely fail to produce results, but could have large returns if successful. Which of the following statements is **NOT** correct?
- A. He can write off the partnership losses against his taxable capital gains.
  - B. He can write off the partnership losses against his employment income.
  - C. His limited partnership loss can be carried forward indefinitely and carried back 3 years.
  - D. His deductible partnership losses will be limited to \$250,000.

***Transfer of Property To And From A Partnership***

34. Aba has just become a partner of the Thursday Partnership. She has a pick up truck which previously used in her own gardening business, and which would be useful to the partnership, and as her initial capital contribution, she transfers the truck to the partnership. The truck cost her \$45,000, has a UCC of \$28,000 and a fair market value of \$35,000. The other partner can only contribute cash of \$30,000, so the partnership pays Aba \$5,000 in cash to keep the initial contributions equal. What are the tax consequences of this transaction?
- A. Aba will have disposed of the truck for \$35,000 resulting in recapture. The adjusted cost base of her partnership interest will be \$35,000. The partnership will have acquired the truck for \$35,000.
  - B. Aba will have disposed of the truck for \$30,000 resulting in recapture. The adjusted cost base of her partnership interest will be \$30,000. The partnership will have acquired the truck for \$30,000.
  - C. Aba will have disposed of the truck for \$35,000 resulting in recapture. The adjusted cost base of her partnership interest will be \$30,000. The partnership will have acquired the truck for \$35,000.
  - D. Aba will have disposed of the truck for \$30,000 resulting in recapture. The adjusted cost base of her partnership interest will be \$35,000. The partnership will have acquired the truck for \$30,000.
35. Aissa has just become a partner of the Gratitude Partnership. She has some vacant land that is in a perfect location for a building the partnership wants to construct. As her initial capital contribution, she transfers the land to the partnership. The land cost her \$45,000 and has a fair market value of \$95,000. No consideration is received from the partnership. What are the tax consequences of this transaction?
- A. Aissa will have disposed of the land for its original cost of \$45,000. The adjusted cost base of her partnership interest will be \$45,000. The partnership will have acquired the land for \$45,000.
  - B. Aissa will have disposed of the land for \$95,000 resulting in a taxable capital gain of \$25,000. The adjusted cost base of her partnership interest will be \$95,000. The partnership will have acquired the land for \$95,000.
  - C. Aissa will have disposed of the land for \$95,000 resulting in a taxable capital gain of \$25,000. The adjusted cost base of her partnership interest will be \$70,000. The partnership will have acquired the land for \$70,000.
  - D. Aissa will have disposed of the land for \$45,000. The adjusted cost base of her partnership interest will be \$95,000. The partnership will be considered to have acquired the land for \$95,000.

36. The Happy Endings Partnership transfers a piece of land to Chata, a partner with a 35 per cent interest in the partnership. The land has an adjusted cost base of \$62,000 and a fair market value of \$88,000. What will the effect of this be on the adjusted cost base of Chata's partnership interest?
- A. A decrease of \$62,000.
  - B. A decrease of \$78,900.
  - C. A decrease of \$83,450.
  - D. A decrease of \$88,000.
37. Which of the following assets can be transferred by a partner to a Canadian partnership under ITA 85(1), but cannot be transferred to a Canadian corporation under ITA 85(1)?
- A. Inventory of goods for resale.
  - B. Vacant land.
  - C. Inventory of real property.
  - D. Non-depreciable property which has declined in value since being purchased.

## **TIF PROBLEM EIGHTEEN - 4**

### **Partnerships - Exam Exercises**

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#### ***Exam Exercise Subject Listing For Chapter 18***

<b>Number</b>	<b>Subject</b>
1	Partnership Income - Accrual Basis
2	Partnership Income - Accrual Basis
3	Partnership Net Business Income
4	Partnership Net Business Income
5	Partnership Income Allocations
6	Partnership Income Allocations
7	Allocations To Partners - Related Tax Credits
8	Allocations To Partners - Related Tax Credits
9	Admission Of A Partner
10	Admission Of A Partner
11	Adjusted Cost Base Of Partnership Interest
12	Adjusted Cost Base Of Partnership Interest
13	Limited Partnership Losses
14	Limited Partnership Losses
15	Transfers From Partner To Partnership - No Rollover
16	Transfers From Partner To Partnership - No Rollover
17	Transfers From Partnership To Partners
18	Transfers From Partnership To Partners
19	Transfers From Partner To Partnership - Rollover
20	Transfers From Partner To Partnership - Rollover

**Exam Exercise Eighteen - 1 (Partnership Income - Accrual Basis)**

During the year ending December 31, 2016, WIN Partnership has business income of \$80,000, capital gains of \$23,000, and receives eligible dividends of \$8,500. Sally Winters has a 40 percent interest in the income of this partnership. During 2016, Sally withdraws \$25,000 from the partnership.

Determine the tax consequences for Ms. Winters for the 2016 taxation year.

**Exam Exercise Eighteen - 2 (Partnership Income - Accrual Basis)**

James Bonner is one of four brothers who have formed a partnership. They each have a 25 percent interest in the partnership.

During the year ending December 31, 2016, the partnership has the following sources of income:

Business Income	\$140,000
Capital Gains	18,000
Eligible Dividends Received	41,000

During 2016, James withdraws \$15,000 in cash from the partnership.

Determine the tax consequences for James for the 2016 taxation year.

**Exam Exercise Eighteen - 3 (Partnership Net Business Income)**

The ID Partnership has two partners. Partner I, because he is actively managing the partnership, receives an annual salary of \$42,000. Because Partner D has contributed most of the capital for the business, he receives an interest allocation of \$17,000. The partnership agreement calls for the remaining profits, and all other allocations, to be split 55 percent to I and 45 percent to D. The salary and interest amounts are deducted in the determination of accounting Net Income.

During the taxation year ending December 31, 2016, the partnership's accounting Net Income is \$312,000. Other relevant information is as follows:

- The accountant deducted amortization charges of \$41,000. Maximum CCA is \$63,000.
- Accounting Net Income includes a deduction for charitable donations of \$4,200.
- Accounting Net Income includes a gain on the sale of land of \$31,000.

Determine the amounts of Net Business Income that will be allocated to Partner I and Partner D for the year ending December 31, 2016.

**Exam Exercise Eighteen - 4 (Partnership Net Business Income)**

The Keisha Partnership has income for accounting purposes for the year ended December 31, 2016 of \$625,000. The two partners have an equal share in this income. The following amounts have been included in the calculation of accounting income:

Meals And Entertainment Costs	\$32,000
Loss On Sale Of Investments	48,000
Golf Club Dues For Partners	25,000
Accounting Amortization	62,000

You have correctly calculated CCA of \$47,000 and a terminal loss of \$31,000.

How much business income should be allocated to each partner for tax purposes?

**Exam Exercise Eighteen - 5 (Partnership Income Allocations)**

The MP Partnership has two partners who share all types of income on an equal basis. Partners M and P are both individuals. The Partnership's accounting Net Income for the year ending December 31, 2016 is \$78,000. No salaries or interest payments to partners have been included in this calculation. However, the \$78,000 includes \$6,500 in eligible dividends, as well as a \$16,000 gain on the sale of unused land. Amortization Expense deducted is equal to maximum CCA.

Determine the amounts that will be included in the Net Income For Tax Purposes of Partner M and Partner P for the year ending December 31, 2016.

**Exam Exercise Eighteen - 6 (Partnership Income Allocations)**

For the taxation year ending December 31, 2016, the Barton Partnership has an accounting Net Income of \$242,000. In determining this figure, no deductions were made for either partner salaries or interest on partner capital contributions. However, the figure does include \$14,000 in eligible dividends received and a capital gain on the sale of investments of \$52,000.

The partnership has two members, Sam Barton and Sherri Barton. All income is allocated on the basis of 40 percent to Sam and 60 percent to Sherri.

Determine the amounts that will be included in the Net Income For Tax Purposes of Sam Barton and Sherri Barton for the year ending December 31, 2016.

**Exam Exercise Eighteen - 7 (Allocations To Partners - Related Tax Credits)**

For the year ending December 31, 2016, the PU Partnership has correctly computed its Net Business Income to be \$213,000. The partnership agreement calls for all allocations to Partner P and Partner U to be on a 40:60 basis. Partner P and U are both individuals and neither has Taxable Income that will be taxed federally at 33 percent.

In determining the Net Business Income amount, the partnership's accountant added back \$4,200 in charitable donations and \$900 in contributions to a registered political party. In addition, \$2,700 in eligible dividends received were deducted. The partners have made no charitable donations or political contributions as individuals. None of the partners is eligible for the first-time donor's super credit.

Determine the amount of any tax credits that will be allocated to Partner P and Partner U for the year ending December 31, 2016.

**Exam Exercise Eighteen - 8 (Allocations To Partners - Related Tax Credits)**

The Coop Partnership has two members, John and Jill Walther, who share all income on a 60:40 basis. Neither partner has Taxable Income that will be taxed federally at 33 percent.

During the year ending December 31, 2016, accounting income has been computed as \$346,000. This accounting figure includes the following items:

Charitable Donations	\$4,500
Contributions To A Registered Political Party	600
Eligible Dividends Received	14,000

The partners have made no charitable donations or political contributions as individuals. None of the partners is eligible for the first-time donor's super credit.

Determine the amount of any tax credits that will be allocated to John and Jill Walther for the year ending December 31, 2016.

**Exam Exercise Eighteen - 9 (Admission Of A Partner)**

Natasha and Felicia are equal partners in the Natty Partnership. On April 30, 2016, Natasha and Felicia's partnership capital account balances are \$148,800 each. This amount is also equal to the adjusted cost base of their partnership interests. Kyra is admitted as an equal partner on April 30, 2016, and pays \$124,000 to each of Natasha and Felicia. Calculate the tax effects of the partner admission for Natasha and Felicia and determine the capital account balances and adjusted cost base for each partner after the admission of Kyra.

**Exam Exercise Eighteen - 10 (Admission Of A Partner)**

Jerry and Joan are equal partners in the JJ Partnership. On January 1, 2016, the balance in each of their capital accounts is \$210,000. This is also the adjusted cost base of their partnership interests. On this date, John is admitted as an equal partner, paying \$130,000 to each of Jerry and Joan. Calculate the tax effects of the partner admission for Jerry and Joan. In addition, determine the capital account balances and adjusted cost base for each partner after the admission of John.

**Exam Exercise Eighteen - 11 (Adjusted Cost Base Of Partnership Interest)**

On January 1, 2016, Rachel and Roberta form the Racherta Partnership. The partnership agreement provides Roberta with a 40 percent share of profits and losses. Roberta initially contributes \$52,500 and makes a further contribution of \$30,240 on May 15, 2016. She withdraws \$16,800 on August 31, 2016. The Racherta Partnership has the following sources of income for the year ending December 31, 2016:

Capital Gain On Sale Of Shares	\$ 48,720
Eligible Dividends Received From Canadian Corporations	13,020
Net Business Income	196,140

Determine the adjusted cost base of Roberta's partnership interest on December 31, 2016, and at January 1, 2017. In addition, determine the amount that would be included in Roberta's 2016 Net Income For Tax Purposes as a consequence of her interest in the Racherta Partnership.

**Exam Exercise Eighteen - 12 (Adjusted Cost Base Of Partnership Interest)**

The XL Partnership is formed on January 1, 2016. Xena is entitled to 60 percent of the Partnership income, while Larry is entitled to the remaining 40 percent.

Xena's original investment is \$125,000. Later in 2016, she makes a further contribution of \$75,000. Also during 2016, she withdraws \$40,000 in anticipation of the Partnership profits.

During the taxation year ending December 31, 2016, the XL Partnership has the following sources of income:

Net Business Income	\$435,000
Eligible Dividends Received	26,000
Capital Gain On The Sale Of Shares	31,000

Determine the adjusted cost base of Xena's partnership interest on December 31, 2016, and at January 1, 2017. In addition, determine the amount that would be included in Xena's 2016 Net Income For Tax Purposes as a consequence of her interest in the XL Partnership.

**Exam Exercise Eighteen - 13 (Limited Partnership Losses)**

During 2016, Blake Robson acquires an interest in a real estate limited partnership for \$235,000, consisting of a cash payment of \$62,000 along with the assumption of a loan of \$173,000. The loan is payable in six years. The general partner has agreed to purchase Blake's interest at any time, returning his \$62,000 payment and assuming full responsibility for the loan, without regard to the current value of the interest. For 2016, the limited partnership has allocated losses of \$81,400 to Blake. How much of this loss is Blake entitled to claim as a deduction on his 2016 tax return? What is the amount of his limited partnership loss at the end of 2016?

**Exam Exercise Eighteen - 14 (Limited Partnership Losses)**

Early in 2016, Bobby Joe Hyder purchased an interest in a limited partnership for \$450,000. Of this amount \$250,000 is paid in cash, with the remainder payable on January 1, 2019. If Bobby Joe transfers his interest to the general partner prior to January 1, 2019, the general partner will pay him \$100,000 and assume full responsibility for the balance due on January 1, 2019.

For 2016, the limited partnership has allocated losses of \$132,000 to Bobby Joe. How much of this loss is Bobby Joe entitled to claim as a deduction on his 2016 tax return? What is the amount of his limited partnership loss at the end of 2016?

**Exam Exercise Eighteen - 15  
(Transfers From Partner To Partnership - No Rollover)**

Martha Stuart is one of four partners in the Homemaker Partnership (HP). During the current year, Martha contributes a tract of land to the partnership. Martha acquired the land for \$59,400 and, at the time of transfer, it is valued at \$180,000. Martha does not use a rollover provision to make the transfer. Describe the tax consequences to Martha and HP in the following three situations:

- A. No consideration is received from HP.
- B. Martha receives \$45,000 in cash from HP on the transfer.
- C. Martha receives \$201,600 in cash from HP on the transfer.

**Exam Exercise Eighteen - 16  
(Transfers From Partner To Partnership - No Rollover)**

Ethan Allen is one of three partners in the Colonial Partnership (CP). During 2016, Ethan transfers land to the partnership. The partners agree that the land has a fair market value of \$220,000. Ethan's adjusted cost base for the land is \$100,000. Describe the tax consequences to Ethan and CP in the following three situations:

- A. No consideration is received from CP.
- B. Ethan receives \$60,000 in cash from CP on the transfer.
- C. Ethan receives \$250,000 in cash from CP on the transfer.

**Exam Exercise Eighteen - 17 (Transfers From Partnership To Partners)**

Lamar is one of 10 equal partners in the Trident Partnership. During the taxation year ending December 31, 2016, Trident distributes debenture bonds that were held for investment purposes to each of the partners. These bonds have an adjusted cost base of \$567,750 and, at the time of transfer, they have a fair market value of \$611,750. Lamar receives 10 percent of these bonds. At the time of the transfer, the adjusted cost base of Lamar's partnership interest is \$75,800. What are the tax consequences to Trident and Lamar with respect to this distribution? Your answer should include the adjusted cost base of Lamar's partnership interest on both December 31, 2016 and January 1, 2017.

***Exam Exercise Eighteen - 18 (Transfers From Partnership To Partners)***

Patricia Flood holds a 25 interest in the Markham Partnership. The Partnership holds securities with an adjusted cost base of \$250,000 and a fair market value of \$475,000. During the taxation year ending December 31, 2016, the Partnership has decided to distribute these securities to the partners in proportion to their interests. Patricia receives 25 percent of these securities and, at the time that they are received, the adjusted cost base of her partnership interest is \$180,000.

What are the tax consequences to Patricia and Markham with respect to this distribution? Your answer should include the adjusted cost base of Patricia's partnership interest on both December 31, 2016 and January 1, 2017.

***Exam Exercise Eighteen - 19 (Transfers From Partner To Partnership - Rollover)***

Sol Marinara is one of four equal partners in the MSG Partnership. During the current year, Sol transfers land to the partnership as a capital contribution. He had acquired the land several years ago for \$146,000. At the time of transfer, it is valued at \$472,000. He would like to use any available rollover provision in order to minimize his current taxes. Assuming the appropriate rollover provision is used, what are the tax consequences of this transfer?

***Exam Exercise Eighteen - 20 (Transfers From Partner To Partnership - Rollover)***

Sarah Bright owns a tract of land that was acquired several years ago at a cost of \$250,000. It currently has a fair market value of \$600,000. She would like to transfer this land to a partnership in which she is one of 6 equal partners. In making the transfer, she would like to use any available rollover provision that would reduce current taxation. Assuming the appropriate rollover provision is used, what are the tax consequences of this transfer?

## **TIF PROBLEM EIGHTEEN - 5A**

### **Partnerships - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of the Chapter 18, “Partnerships”.

- A. At-Risk Amount
- B. Canadian Partnership
- C. General Partner
- D. Limited Liability Partnership
- E. Limited Partnership
- F. Limited Partnership Loss
- G. Partnership Interest
- H. Partner

The following list contains ten potential definitions for the preceding key terms.

1. A person who is a member of a partnership.
2. A partner whose liabilities for partnership debts is limited to the amount of his contribution to the partnership, and who is not permitted to participate in the management of the partnership.
3. The excess of losses allocated to a limited partner (other than farming or capital losses), over his at-risk amount.
4. A partner whose personal liability for the debts and obligations of the partnership is not limited.
5. An arrangement in which two or more persons work together in a limited and defined business undertaking, which does not constitute a partnership, a trust, or a corporation, the expenses and revenues of which will be distributed in mutually agreed portions.
6. A non-depreciable capital property that reflects the partner’s original cost, adjusted for earnings, withdrawals, and other factors.
7. A defined measure that limits the amount of deductions that can be flowed through to a limited partner.
8. A partnership, all of the members of which are legislatively specified professionals. The members of such partnerships are relieved of any personal liability arising from the wrongful or negligent action of their professional partners, as well as employees, agents, or representatives of the partnership who are conducting partnership business.
9. A partnership, all of the members of which are residents of Canada at the time the term is relevant.
10. A partnership composed of at least one general partner and at least one limited partner.
11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 11) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply. Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM EIGHTEEN - 5B**

### **Partnerships - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of the Chapter 18, “Partnerships”.

- A. At-Risk Amount
- B. Canadian Partnership
- C. General Partner
- D. Limited Liability Partnership
- E. Limited Partnership
- F. Limited Partnership Loss
- G. Partnership Interest
- H. Partner

The following list contains 14 potential definitions for the preceding key terms.

1. A person who is a member of a partnership.
2. A partnership that carries on all of its business only in Canada.
3. A partner whose liabilities for partnership debts is limited to the amount of his contribution to the partnership, and who is not permitted to participate in the management of the partnership.
4. The excess of losses allocated to a limited partner (other than farming or capital losses), over his at-risk amount.
5. A partner whose personal liability for the debts and obligations of the partnership is not limited.
6. An arrangement in which two or more persons work together in a limited and defined business undertaking, which does not constitute a partnership, a trust, or a corporation, the expenses and revenues of which will be distributed in mutually agreed portions.
7. A non-depreciable capital property that reflects the partner’s original cost, adjusted for earnings, withdrawals, and other factors.
8. The excess of all losses allocated to a limited partner (other than farming or capital losses) over his capital contribution.
9. Two or more persons who combine forces to carry on a business together for the purpose of making a profit by contributing their skills, knowledge, labour, experience, time, or capital.
10. A defined measure that limits the amount of deductions that can be flowed through to a limited partner.

*Partnerships - Key Term Matching (Moderate)*

11. A partnership, all of the members of which are legislatively specified professionals. The members of such partnerships are relieved of any personal liability arising from the wrongful or negligent action of their professional partners, as well as employees, agents, or representatives of the partnership who are conducting partnership business.
12. The amount a limited partner has invested in the partnership and could potentially lose to creditors.
13. A partnership, all of the members of which are residents of Canada at the time the term is relevant.
14. A partnership composed of at least one general partner and at least one limited partner.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## TIF PROBLEM EIGHTEEN - 6

### Existence Of Partnership

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John and Janet Bovi have been married for 12 years. John is a professional recording artist earning substantial income. Janet stays home and raises their 4 children. Three years ago, John began a stereo speaker repair business. John acquired a building, tools, office furniture and hired repair technicians. He also registered the business and opened up a bank account under his own name. John spends a few hours each day managing the business.

John and Janet report profits as a partnership on a 50:50 basis when filing their annual income tax returns. There is no partnership agreement.

**Required:** In the following two **independent** Cases, determine whether a partnership exists.

- A. Janet's involvement with the business consists of helping John pick out some office furniture and occasionally taking messages when John is out of town. The business has been profitable each year.
- B. Janet does all the accounting, payroll and invoicing for the repair business from home. She also does most of the parts ordering on-line and is responsible for paying the suppliers and all other expenses. The business has not been profitable in any year.

## **TIF PROBLEM EIGHTEEN - 7**

### **Partnership Income Allocation**

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Sara and Ann Fleck are sisters with many years of experience as lawyers. They specialize in divorce litigation, usually for high net worth clients. For several years now they have operated as a partnership.

The partnership agreement calls for them to share all types of income equally. Profits are determined using a fiscal year that ends on December 31.

Their accountant has prepared the following statement for the year ending December 31, 2016.

**Sara And Ann Fleck**  
**Partnership Income Statement**  
**Year Ending December 31, 2016**

Revenues		\$1,360,000
Expenses:		
Salaries To Staff	(\$461,000)	
Office Rent	( 102,000)	
Office Supplies	( 47,000)	
Amortization	( 41,000)	
Charitable Donations	( 26,000)	
Drawings By Sara	( 212,000)	
Drawings By Ann	( 241,000)	( 1,130,000)
<hr/>		
Net Income From Law Practice		<u>\$ 230,000</u>

**Other Information:**

1. The sisters have elected under ITA 34 to report Taxable Income on a billed basis. The revenues in their accounting statement include a December 31, 2016 balance of unbilled work-in-process of \$314,000. The corresponding balance on December 31, 2015 was \$163,000.
2. The sisters would like to take maximum CCA for tax purposes. For the year ending December 31, 2016 this amount is \$54,000.
3. In addition to the business results recorded in the accounting income statement, the partnership had the following additional amounts of 2016 income:
  - Eligible Dividends Received \$46,000
  - Gain On Sale Of Common Shares \$68,000
4. Assume that neither partner has Taxable Income that will be taxed federally at 33 percent.

**Required:**

- A. Calculate the amounts of income from the partnership that would be included in the Net Income For Tax Purposes of each of the two sisters.
- B. Indicate the amount of any federal tax credits that would be available to the two sisters as a result of their interest in the partnership.

## **TIF PROBLEM EIGHTEEN - 8**

### **Partnership Income Allocation**

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Sam and Allen Foster are both Chartered Professional Accountants. Since acquiring their professional designations, they have both worked for a large firm of Certified General Management Accountants. However, at the beginning of 2016, they have decided to leave this firm and form a two man partnership specializing in tax and accounting work for owner-managed corporations.

The agreement for the new partnership calls for business income to be shared equally. In addition, charitable contributions will be allocated equally to the two brothers. However, as Allen has contributed most of the capital for the new partnership, he will receive 80 percent of any capital gains or dividends received by the partnership.

For the year ending December 31, 2016, their results, prepared on a GAAP basis, are as follows:

**Sam And Allen Foster**  
**Partnership Income Statement**  
**Year Ending December 31, 2016**

Revenues		\$965,000
Expenses:		
Salaries To Staff	(\$114,000)	
Office Rent	( 82,000)	
Office Supplies	( 30,000)	
Amortization	( 32,000)	
Business Meals And Entertainment	( 14,000)	
Charitable Donations	( 13,000)	
Salary To Sam	( 150,000)	
Salary To Allen	( 150,000)	( 585,000)
Net Business Income		\$380,000
Other Income:		
Capital Gains	\$ 8,000	
Eligible Dividends Received	16,000	24,000
Accounting Net Income		\$404,000

**Other Information:**

1. The brothers plan to deduct the maximum CCA for tax purposes which is \$41,000.
2. The brothers have decided to use the ITA 34 election to report Taxable Income on a billed basis. The revenues in the Accounting Net Income include \$56,000 in unbilled work-in-process. As this is their first year of operation, there was no unbilled work-in-process balance on January 1.
3. Assume that neither partner has Taxable Income that will be taxed federally at 33 percent.

**Required:**

- A. Calculate the amounts of income from the partnership that would be included in the Net Income For Tax Purposes of each of the two brothers.
- B. Indicate the amount of any federal tax credits that would be available to the two brothers as a result of their interest in the partnership.

## **TIF PROBLEM EIGHTEEN - 9**

### **Partnership Income Allocation With ACB**

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Two of your university friends, who became lawyers, left the firms where they were employed, and set up their own practice on January 1, 2016. They started the practice by contributing \$10,000 working capital each and decided to split the profits equally. They pay themselves equal salaries that they withdraw throughout the year. Their bookkeeper has prepared the following financial statements:

**Friends Forever Law Practice**  
**Balance Sheet**  
**As At December 31, 2016**

Cash	\$ 2,000
Accounts Receivable	30,000
Work In Progress	25,000
Computer Hardware (At Cost)	10,000
Computer Applications Software (At Cost)	8,000
Total Assets	\$75,000
Accounts Payable	\$15,000
Initial Partner Capital	20,000
Income For The Period	40,000
Total Equities	\$75,000

**Friends Forever Law Practice**  
**Income Statement**  
**For The Year Ending December 31, 2016**

Revenues	\$230,000
Meals And Entertainment	\$ 6,000
Office Supplies	4,000
Partners' Salaries	130,000
Rent	24,000
Secretary's Salary	26,000
Total Expenses	\$190,000
Income For The Period (Accounting Values)	\$ 40,000

The work in progress represents work done by the lawyers at their standard charge rate that has not been billed to clients at the year end.

**Required:**

- A. Your friends have come to you to determine the minimum amount that they must include in their 2016 tax returns as business income from the partnership.
- B. They would also like to know if there are any partnership related expenses that they may have incurred personally that they can deduct on their 2016 tax return.
- C. Compute the ACB of each partner's partnership interest at December 31, 2016 and January 1, 2016.

Your answers should ignore GST and PST considerations.

## TIF PROBLEM EIGHTEEN - 10

### Withdrawal Of A Partner

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Bob Darin, Matt Monroe, and John Mathis formed a partnership on April 1, 2014. The partnership provides engineering services to a variety of clients and has a December 31 year end. 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:

**Net Business Income** The net 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, 2014 to December 31, 2016, the following information is available:

- The partnership earned net business income of \$233,460.
- The partnership realized a \$18,464 capital gain (this amount is not included in the net business income figure).
- The partnership received eligible dividends totalling \$4,689 (this amount is not included in the net business income figure).
- During 2016, the partnership made a number of charitable donations. The total amount involved was \$8,460 (this amount is not included in the net business income figure).
- Additional capital was required to expand the operations of the office and, as a consequence, each partner contributed an additional \$75,000 in cash.
- During this period, withdrawals from the partnership were as follows: Bob Darin, \$112,000, Matt Monroe, \$234,000 and John Mathis, \$55,000.

Near the end of 2016, John Mathis has concluded that he does not enjoy working with the other partners. Given this, he decides to withdraw from the partnership, effective January 1, 2017. After some negotiations, each of the other partners agreed to pay him \$160,000 in cash for one-half of his interest in the partnership, a total of \$320,000. The payments are made on February 1, 2017. The partnership has net business income of \$21,000 in January, 2017.

John incurred legal and accounting fees in conjunction with this transaction totaling \$1,800.

#### Required:

- A. Calculate the adjusted cost base of John's partnership interest as of January 1, 2017.
- B. Determine the amount of John's gain or loss on the disposition of his partnership interest. Explain how this amount, and any other amounts related to the partnership, will be taxed in his hands during 2017.
- C. Indicate how the adjusted cost base of each partner's interest will be affected by the withdrawal of John from the partnership.

## **TIF PROBLEM EIGHTEEN - 11**

### **Limited Partnership**

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On January 1, 2016, Bob Billions acquires a 12 percent limited partner interest in the Who-Do-You-Trust Partnership. The total cost of the interest is \$65,000, with \$5,000 being paid in cash. A \$60,000 interest-free promissory note is signed for the balance. The note is to be paid in 6 payments of \$10,000 each. Payments are due on December 1 of each year, commencing in 2016.

As part of the agreement, the general partner is obligated to acquire Bob's interest on December 31, 2021 for \$5,000 more than its fair market value at that time.

Bob's share of all of the income and losses of the Who-Do-You-Trust Partnership is 12 percent.

For the year ending December 31, 2016, the Partnership had the following sources of income and loss:

Business Loss	(\$510,000)
Interest Income	63,000
Eligible Dividends Received From Canadian Corporations	31,000
Capital Gains	53,000

**Required:** Calculate the following amounts for Bob's investment in the Who-Do-You-Trust Partnership for 2016:

- The at-risk amount on December 31, 2016.
- The limited partnership income (loss) for the year.
- The deductible loss for the year.
- The limited partnership loss carry forward at the end of the year.
- The adjusted cost base on December 31, 2016 and January 1, 2017.
- The at-risk amount on January 1, 2017.

## **TIF PROBLEM EIGHTEEN - 12**

### **Limited Partnership**

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At the beginning of 2016, Martin Plunger purchases a 30 percent interest in income and losses of the Risky Business Partnership for \$150,000. Of this amount \$50,000 is paid immediately. The remaining \$100,000 is due on January 1, 2017.

The general partner that formed the Risky Business Partnership has agreed to buy back his interest for \$60,000, without regard to its fair market value on the buy back date. However, this agreement expires on January 1, 2018.

During the year ending December 31, 2016, the Risky Business Partnership records a \$975,000 business loss. Also during the year, the partnership has a \$50,000 capital gain.

During the year ending December 31, 2017, the Risky Business Partnership has a further business loss of \$180,000. There are no other sources of income during the year.

During 2018, the Risky Business Partnership has no business losses and no other sources of income.

Martin does not ask the general partner to buy back his interest before the agreement expires on January 1, 2018.

Martin has sufficient other sources of income to absorb any deductible losses generated by the partnership.

**Required:** For each of 2016, 2017 and 2018, calculate the following amounts related to Martin's interest in the Risky Business Partnership:

- The adjusted cost base at the end of the year.
- The at-risk amount.
- The limited partnership income (loss) for the year.
- The deductible income (loss) for the year.
- The limited partnership loss carry forward at the end of the year.

## **TIF PROBLEM EIGHTEEN - 13**

### **Transfer Of Partnership To A Corporation**

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**Note To Instructor** As some of the issues in this problem are not covered directly in the text, this question should not be used on an examination unless Assignment Problem Eighteen-29 has been covered in your classes.

***(Partnership Winding-Up & Transfer To Corporation)***

A number of years ago, Jack Howard, Bud Jones, and Dwight Delaney established the Howard, Jones, and Delaney Partnership. At the time the partnership was formed, each of the partners invested \$600,000 in cash. The partnership agreement calls for all income and losses to be shared equally. The fiscal year of the partnership ends on December 31.

On January 1 of the current year, the adjusted cost base of the partnership interests that are applicable to the three partners are as follows:

Jack Howard	\$1,173,000
Bud Jones	930,000
Dwight Delaney	756,000
<b>Total</b>	<b>\$2,859,000</b>

The total tax cost of the net assets of the partnership is equal to the \$2,859,000 adjusted cost base of the partnership interests. On January 2 of the current year, the net assets of the partnership are transferred to a corporation under the provisions of ITA 85(2). The elected values are equal to the tax costs of the individual assets and liabilities.

It has been determined that the fair market value of the partnership is \$3,900,00. Based on this, the corporation provides the following consideration to the partnership:

Cash	\$1,200,000
Preferred Shares (At Fair Market Value)	900,000
Common Shares (At Fair Market Value)	1,800,000
<b>Total Consideration</b>	<b>\$3,900,000</b>

The partnership will be liquidated within 60 days of the ITA 85(2) rollover and property received from the corporation by the partnership will be transferred to the three partners in accordance with ITA 85(3). Under the terms of the partnership agreement, they receive the following amounts:

	<b>Howard</b>	<b>Jones</b>	<b>Delaney</b>	<b>Total</b>
Cash	\$ 620,000	\$ 377,000	\$ 203,000	\$1,200,000
Preferred Shares	300,000	300,000	300,000	900,000
Common Shares	600,000	600,000	600,000	1,800,000
<b>Total</b>	<b>\$1,520,000</b>	<b>\$1,277,000</b>	<b>\$1,103,000</b>	<b>\$3,900,000</b>

**Required:**

- A. Determine the adjusted cost base of each of the assets received by the partners as a result of the transfer of partnership assets to the corporation.
- B. Calculate the capital gain or loss for each partner resulting from the transfer of the consideration received by the partnership to the partners in return for the partnership interest.

**TIF PROBLEM EIGHTEEN - 14****Partnership Income Allocation And Sale Of Interest**

Sarah and Shelly Duval are sisters and professional accountants. While both sisters had worked in large firms for several years, on January 1, 2015 they decided to leave their former employers and form a partnership. At this time, they each made a capital contribution of \$235,000 in cash. Their partnership agreement calls for them to share all profits and losses equally.

During the partnership taxation year ending December 31, 2015, the partnership had Net Income For Tax Purposes of \$225,000, all of which was business income. The partnership made no charitable donations in 2015. During this taxation year, Sarah withdrew \$85,000 and Shelly withdrew \$72,000.

The partnership's 2016 Income Statement, prepared in accordance with generally accepted accounting principles, is as follows:

**Income Statement**  
**Sarah And Shelly Duval Partnership**  
**Year Ending December 31, 2016**

Revenues		\$565,000
Operating Expenses:		
Rent	(\$37,000)	
Amortization Expense (Note 1)	( 9,000)	
Office Salaries	( 47,000)	
General Office Costs	( 14,000)	
Meals And Entertainment	( 11,000)	
Charitable Donations	( 23,000)	( 141,000)
Operating Income		\$424,000
Other Income:		
Gain On Sale Of Investments (Note 2)	\$ 6,000	
Non-Eligible Dividends Received From Canadian Corporations	13,000	19,000
Net Income		\$443,000

**Note 1** Maximum 2016 CCA, which the partners intend to deduct, is \$14,000.

**Note 2** The gain resulted from the sale of temporary investments. The investments had an adjusted cost base of \$41,000 and were sold for \$47,000.

**Other Information**

1. The revenues in the accounting based Income Statement include \$72,000 in unbilled work in progress. There was no unbilled work in progress at the end of the previous year. The sisters will use the ITA 34 election to record the partnership income on a billed basis.
2. During 2016, Sarah had drawings of \$205,000 while Shelly had drawings of \$187,000.
3. During 2016, Shelly's only income was from the partnership. Assume that other than credits related to partnership allocations, Shelly's only tax credit was her basic personal credit. She is not eligible for the first-time donor's super credit.
4. On January 1, 2017, Shelly sells her interest in the partnership to an arm's length individual for \$435,000.

**Required:** Calculate Shelly's federal Tax Payable for the year ending December 31, 2016. In addition, determine the taxable capital gain or allowable capital loss that would result from Shelly's sale of her partnership interest. Ignore any CPP implications with respect to self-employment income.

## Chapter Nineteen Test Item File Problems

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### TIF PROBLEM NINETEEN - 1

#### Trusts - Essay Questions

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1. The three types of persons who are associated with a trust are usually described as the settlor, the trustee, and the beneficiary. Briefly describe the role of these persons with respect to the trust.
2. The text notes that it is, in general, difficult to revoke or vary a trust. What is the importance of this characteristic?
3. Briefly compare the tax perspective on trusts with the legal perspective on these arrangements.
4. Legally, the estate of a deceased individual is not the same as a trust. Given this, why does the *Income Tax Act* use the terms estate and trust as though they had the same meaning?
5. In order for a trust to exist, three characteristics must be established with certainty. What are these three characteristics?
6. Briefly describe two non-tax reasons for using a trust.
7. What is a "personal trust"?
8. Describe the basic model that is used for the taxation of trusts. Your answer should include the tax effects for settlors, the trust itself, and the beneficiaries.
9. What is the difference between an inter vivos trust and a testamentary trust? Explain briefly how Tax Payable is calculated for these two types of trusts.
10. What is a qualifying spousal trust? What is the major tax advantage associated with a trust being classified as a qualifying spousal trust? Briefly describe two non-tax reasons for using a qualifying spousal trust.
11. What conditions must be satisfied in order for a trust to qualify as an alter ego trust? Briefly describe the income tax and non-income tax reasons for using an alter ego trust.
12. In order to avoid probate fees, an Ontario resident is planning to transfer all of his capital assets to a joint spousal trust. These assets have a significant amount of accumulated capital gains. He is aware that a tax free rollover is available. He is also aware that he can elect out of this rollover position. Why might he want to make this election?
13. What are the tax consequences associated with a transfer of trust assets to a capital beneficiary?
14. Briefly describe the 21 year deemed disposition rule. Your answer should include the objective of this rule.
15. The preferred beneficiary election allows amounts to be taxed in the hands of a beneficiary even though the amounts have not been distributed to that beneficiary. What is the objective of this election?

16. A trust will normally deduct all amounts that are paid or payable to a beneficiary. However, under ITA 104(13.1), it can designate certain amounts that have been paid as “not to have become paid or payable in the year”. This will result in the trust having to include these amounts in its Taxable Income. Why would a trust make such a designation?
17. What is the difference between a discretionary and a non-discretionary trust?
18. Describe the tax treatment that is applicable to capital gains realized within a trust.
19. A testamentary trust has been designated a graduated rate estate (GRE). In accordance with the decedent's will, the widow and the decedent's adult son each receive 40 percent of the GRE's income and the remaining 20 percent of the GRE's income is retained in the GRE. Briefly describe the tax consequences of the income earned and retained by the GRE, and the income distributed by the GRE to the widow and son.
20. What are the consequences for the settlor if the CRA concludes that a trust is a reversionary trust?
21. What is a family trust? What is the usual objective of such trusts?
22. List and describe three non-tax considerations that are involved in estate planning.
23. An estate freeze can be carried out by simply giving property to the intended beneficiaries of future growth. What are the disadvantages of this approach?

## TIF PROBLEM NINETEEN - 2

### Trusts - True Or False

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#### New For 2016/2017

1. The beneficiaries of a trust hold formal legal title to the trust property.  
True or False?
2. If a period of time passes between the time of an individual's death and the distribution of the individual's capital assets, income may accrue on these assets. If this is the case, the administrator of the individual's estate will have to file a T3 trust tax return.  
True or False?
3. To establish a trust, a lawyer must prepare, in writing, a formal trust agreement.  
True or False?
4. A trust can be used to protect some of an individual's assets from the claims of creditors.  
True or False?
5. A spousal or common-law partner trust can either be an inter vivos trust or a testamentary trust.  
True or False?
6. As long as he or she is the only beneficiary, any individual can transfer assets to an Alter Ego trust.  
True or False?
7. Any transfer by a settlor to a trust will be treated as a disposition to be recorded at fair market value.  
True or False?
8. While there are exceptions, transfers to beneficiaries can generally be made without tax consequences to either the trust or the beneficiary.  
True or False?
9. An inter vivos trust can designate amounts to be deemed not paid when they are, in fact, paid or payable to beneficiaries. One reason for doing this would be to have the income taxed at a lower rate in the trust.  
True or False?
10. If a trust receives eligible dividends and does not distribute them or allocate them to a beneficiary, the trust will be eligible for the usual dividend tax credit on such dividends.  
True or False?

#### Retained From Previous Editions

11. The three essential characteristics of a trust are certainty of:
  - the identity of the property to be placed in the trust;
  - an intent on the part of the settlor to create a trust; and
  - the basis for allocating the trust income to the beneficiaries.True or False?

12. Income that is flowed through a trust retains its tax characteristics (e.g., a dividend earned by the trust can be allocated to a beneficiary as a dividend).

True or False?

13. The Tax Payable of an inter vivos trust will be calculated using the same schedule of progressive rates that applies to individuals.

True or False?

14. If capital property is transferred to a qualifying spousal trust, there will be no gain or loss on the transfer, any income earned on the property will be attributed back to the settlor, but capital gains on a disposition of the property by the trust will not be attributed back to the settlor.

True or False?

**TIF PROBLEM NINETEEN - 3****Trusts - Multiple Choice**

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**New For 2016/2017****Basic Concepts**

1. Which of the following statements with respect to inter vivos trusts is **NOT** correct?
  - A. These trusts must use the calendar year as their taxation year.
  - B. Any income that is left in these trusts will be taxed at the maximum federal rate of 33 percent.
  - C. If all of the trust's income is distributed to beneficiaries, the trust will not have any Tax Payable.
  - D. Amounts earned in these trusts are not subject to the income attribution rules.

**Classification of Trusts**

2. For which of the following types of trusts is a tax free rollover available for property transferred to the trust by the settlor?
  1. Inter Vivos spousal trusts.
  2. Testamentary spousal trusts.
  3. Family Trusts
  4. Alter ego trusts.
  - A. 1, 2 and 4.
  - B. 2 and 4.
  - C. 1 and 2.
  - D. 1, 2, 3, and 4.

**Taxation of Trusts**

3. On July 1, 2016, Martin Long transfers shares with a fair market value of \$300,000 to a newly established inter vivos trust. His 35 year old son, Shorty Long, is the only beneficiary. Martin's cost for these securities was \$170,000. During 2016, the trust receives eligible dividends on the shares of \$21,000. All of these dividends are distributed to Shorty.

What are the tax consequences of these transactions to Martin, the trust and Shorty?

- A. The trust will report dividends received of \$21,000 and will claim the dividend tax credit. There will be no tax consequences for Martin or Shorty.
- B. The trust will have no income. Shorty will report dividends received of \$21,000 which must be grossed up and will claim the dividend tax credit. There will be no tax consequences for Martin.
- C. Martin will report a taxable capital gain of \$65,000  $[(1/2)(\$300,000 - \$170,000)]$ . The trust will have no income. Shorty will report dividends received of \$21,000 which must be grossed up and will claim the dividend tax credit.
- D. Martin will report a taxable capital gain of \$65,000  $[(1/2)(\$300,000 - \$170,000)]$ . The trust will report dividends received of \$21,000 which must be grossed up and will claim the dividend tax credit. There will be no tax consequences for Shorty.

**Net income For Tax Purposes Of A Trust**

4. Which of the following items can be allocated to beneficiaries of a trust?
  - A. Losses incurred on the disposition of trust capital property.
  - B. Gains resulting from the disposition of trust capital property.
  - C. Recapture of CCA on the disposition of trust depreciable assets.
  - D. Items A, B, and C.
  - E. Items B and C.

**Income Allocations to Beneficiaries**

5. An inter vivos trust earned \$50,000 in eligible dividends. In addition, it received interest of \$12,000 during the current year. The trust incurred accounting fees of \$2,000 which were claimed by the trust. The trust has one beneficiary who is 23 years old and has no other source of income. During the current year, all of the dividends were distributed to the beneficiary and none of the interest. What is the Net Income For Tax Purposes of the beneficiary?
- A. \$69,000.
  - B. \$67,000.
  - C. \$81,000.
  - D. \$50,000.

**Tax Payable Of Personal Trusts**

6. The Strike family trust is an inter vivos trust with one beneficiary, Maria Strike, the 25 year old daughter of the settlor, Gregor Strike. The trust receives interest income of \$150,000 in 2016. The trust makes a charitable donation of \$15,000 and distributes \$105,000 to Maria. Maria has no income other than what she receives from the trust, and is eligible only for the personal tax credit. Determine the federal Tax Payable for the trust for 2016.
- A. \$14,850.
  - B. \$9,900.
  - C. \$1,836.
  - D. \$9,936.

**Income Attribution**

7. Saddam Holt transfers a number of capital assets to a trust in favour of his spouse, Lena Holt. She is the only income or capital beneficiary of the trust. Which of the following statements with respect to this trust is **NOT** correct?
- A. The income that is left in the trust will be taxed at the maximum federal rate that is applicable to individuals.
  - B. Any property income that is retained in the trust will be attributed back to Mr. Holt.
  - C. Any capital gains that are retained in the trust will not be attributed back to Mr. Holt.
  - D. Any income that is distributed to Mrs. Holt will be attributed back to Mr. Holt.

**Purchase Or Sale Of An Interest In A Trust**

8. The Burton family trust was created when Mr. Burton transferred publicly traded securities with a cost of \$300,000 and a fair market value of \$750,000 into the trust. The beneficiaries are Mr. Burton's two sons, Tim and Jerry Burton, both of whom are over 30 years old. They have equal shares in the income and capital of the trust.

At a later point in time, when the value of the securities has increased to \$2,100,000, Tim purchases Jerry's capital interest in the trust for \$1,050,000  $[(1/2)(\$2,100,000)]$ . The tax consequences of this transaction to Tim and Jerry are as follows:

- A. Tim has acquired a capital interest in the trust with an adjusted cost base of \$1,050,000. Jerry will report a taxable capital gain of \$525,000.
- B. Tim has acquired a capital interest in the trust with an adjusted cost base of nil. Jerry will report a taxable capital gain of \$525,000.
- C. Tim has acquired a capital interest in the trust with an adjusted cost base of \$1,050,000. Jerry will report a taxable capital gain of \$150,000.
- D. Tim has acquired a capital interest in the trust with an adjusted cost base of \$1,050,000. Jerry will report a taxable capital gain of \$337,500.

**Tax Planning**

9. Monique Flaharty has accumulated securities that earn interest of \$45,000 per year. Her other sources of income exceed \$250,000 per year. Her 35 year old daughter Deborah has no income of her own. Her only tax credit is the basic personal tax credit. Determine the amount of federal taxes that could be saved by transferring the interest earning securities to a trust with Deborah as the income beneficiary. The trust will be required to distribute all of its income each year.
- A. \$8,100.
  - B. \$9,821.
  - C. \$5,029.
  - D. \$13,129.

**Estate Freeze**

10. An estate freeze can be accomplished using various means. With respect to the various alternatives, which of the following statements is correct.
- A. Implementing an estate freeze through the use of gifts does not involve any immediate tax consequences.
  - B. The use of Section 85 to implement the estate freeze can avoid immediate tax consequences.
  - C. Implementing an estate freeze with the use of an inter vivos trust can avoid immediate tax consequences.
  - D. An advantage of using gifts to implement an estate freeze is that the freezeor can retain control of the assets.

**Retained From Previous Editions****Basic Concepts**

11. Which of the following is **NOT** required for the successful establishment of a trust?
- A. The settlor must clearly intend to create a trust.
  - B. The individual beneficiaries must be named.
  - C. The property to be held in the trust must be known with certainty.
  - D. There must be an actual transfer of property to the trust.
12. With respect to the role of a trustee, which of the following statements is correct?
- A. The trustee can also be the settlor of the trust, but not one of the beneficiaries.
  - B. The trustee will hold formal legal title to the trust property.
  - C. All of the benefits of the trust will accrue to the trustee.
  - D. The trustee cannot enter into contracts on behalf of the trust.
13. A graduated rate estate is a testamentary trust that has been designated as such in its first tax return. Which of the following statements is correct with respect to graduated rate estates?
- A. Its taxation year must be the calendar year.
  - B. Its tax return is due 90 days after the trust's year end.
  - C. All of its income will be taxed at the highest federal rate of 33 percent.
  - D. It will not be eligible for a dividend tax credit on dividends received and retained in the trust.

**Classification of Trusts**

14. Which of the following statements is **NOT** correct?
- A. A trust can be used to administer assets for beneficiaries with limited asset management experience.
  - B. A trust can be used to ensure that assets are ultimately delivered to the intended beneficiaries.
  - C. A trust can be used to avoid the income attribution rules applicable to a spouse.
  - D. A trust can be used to protect assets from creditors.
15. Which of the following trusts could be either a testamentary or an inter-vivos trust?
- A. An alter ego trust created by an individual who is 65 years of age in anticipation of his death in the near future.
  - B. A spousal trust created to benefit a spouse.
  - C. A family trust established by a parent while alive to benefit his or her children.
  - D. A joint spousal trust created for the benefit of an individual and his spouse.
16. When an individual dies, there is a deemed disposition of certain types of property. This would include property held by one type of trust for which the deceased taxpayer was a settlor. That type of trust is:
- A. A discretionary trust.
  - B. A testamentary trust.
  - C. A joint spousal or common-law partner trust.
  - D. An alter ego trust.
17. Which one of the following statements with respect to a qualifying spousal trust is **NOT** correct?
- A. The transferor's spouse must be entitled to receive all of the income of the trust arising before the spouse's death.
  - B. The settlor must be 65 years of age or older.
  - C. No person other than the spouse may receive or benefit from any of the income or capital of the trust, prior to the death of the spouse.
  - D. A spousal trust can be a non-discretionary trust.
18. Which one of the following statements with respect to an alter ego trust is correct?
- A. An alter ego trust can be either an inter vivos trust or a testamentary trust.
  - B. For the settlor, the proceeds of disposition for property transferred to the trust will be equal to the fair market value of the assets at the time of transfer.
  - C. Any resident individual can settle an alter ego trust.
  - D. When assets are transferred out of an alter ego trust to anyone other than the settlor, the proceeds of disposition to the trust will be the fair market value of the assets transferred.

**Taxation of Trusts**

19. Anika is planning to create a testamentary trust. She has not yet decided if the beneficiaries will be only her common-law partner Belinda, only their 14 year old blind daughter Elena, or both Belinda and Elena equally. The non-depreciable property she will transfer to the trust has an adjusted cost base of \$45,000 and a fair market value of \$75,000. In order to defer the taxation of the capital gain on the transferred property until it is sold by the beneficiary(ies), which alternative should Anika use?
- A. Anika should transfer the property to a trust to benefit only their daughter, Elena.
  - B. Anika should transfer the property to a common-law partner trust.
  - C. Anika should transfer the property to a trust with both Elena and Belinda as beneficiaries.
  - D. Anika cannot defer the taxation of the capital gain with the use of a trust.
20. In 2015, Diego transferred property with an adjusted cost base of \$400,000 and a fair market value of \$750,000 to an alter ego trust. In his will, Diego bequeaths all his property to his son. At his death in 2016, when the trust transfers the property to his son, the fair market value of the property has increased to \$800,000. Diego uses any rollovers that are available to minimize the tax consequences. What are the tax consequences of these two transfers?
- A. In 2015, a rollover would allow Diego to transfer his property to the trust tax free. In 2016, when the trust transfers the property to his son, the trust will include a taxable capital gain of \$200,000  $[(1/2)(\$800,000 - \$400,000)]$  in income.
  - B. In 2015, there will be no rollover available, and Diego will include a taxable capital gain of \$175,000  $[(1/2)(\$750,000 - \$400,000)]$  in income. In 2016, when the trust transfers the property to his son, there will be a rollover available, and the trust will not report any income.
  - C. There will not be a rollover available for either transaction. In 2015, Diego will report a taxable capital gain of \$175,000  $[(1/2)(\$750,000 - \$400,000)]$  in income. In 2016, when the property is transferred to his son, the trust will include a taxable capital gain in income of \$25,000  $[(1/2)(\$800,000 - \$750,000)]$ .
  - D. Rollovers will be available to defer tax on both transactions.
21. In 2015, Emilio, who is 82 years old, transfers property with an adjusted cost base of \$400,000 and a fair market value of \$750,000 to an inter vivos family trust to benefit his 3 adult children. In 2016, he becomes seriously disappointed with his two sons, and decides to have the trust transfer the property to his daughter. Subsequent to the distribution, the trust is wound up. At the time of the trust's distribution to the daughter, the fair market value of the property has increased to \$800,000. For both transactions, Emilio uses any rollovers that are available to minimize the tax consequences. What are the tax consequences of these two transfers?
- A. In 2015, a rollover would allow Emilio to transfer his property to the trust tax free. In 2016, when the trust transfers the property to his daughter, the trust will include a taxable capital gain of \$200,000  $[(1/2)(\$800,000 - \$400,000)]$  in income.
  - B. In 2015, there will be no rollover available, and Emilio will include a taxable capital gain of \$175,000  $[(1/2)(\$750,000 - \$400,000)]$  in income. In 2016, when the trust transfers the property to his daughter, there will be a rollover available, and the trust will not report any income.
  - C. There will not be a rollover available for either transaction. In 2015, Emilio will report a taxable capital gain of \$175,000  $[(1/2)(\$750,000 - \$400,000)]$  in income. In 2016, when the property is transferred to his daughter, the trust will include a taxable capital gain in income of \$25,000  $[(1/2)(\$800,000 - \$750,000)]$ .
  - D. Rollovers will be available to defer tax on both transactions.

**Net income For Tax Purposes Of A Trust**

22. Which of the following amounts will **NOT** be included, either as an inclusion or a deduction, in the determination of the Taxable Income of a trust?
- Retained income which has been allocated to a preferred beneficiary of the trust.
  - Amounts paid or payable to a beneficiary of the trust.
  - The difference between the fair market value and the cost of assets transferred to a capital beneficiary.
  - Amounts that have been paid to a beneficiary but have been designated not to have been paid.
23. Upon his death three years ago, Mr. Allen's will provided for the creation of a trust. The will required that any income distributed by the trust be allocated 50 percent to his wife, and 12.5 percent to each of his four children. During 2016, the trust had the following income and expense:

Eligible Dividends From Canadian Corporations	\$20,000
Interest From Canadian Sources	10,000
Interest Expense On Money Borrowed To Acquire Shares	1,000

For 2016, the beneficiaries and the trustees jointly agreed that all income received by the trust, except for \$5,000 of the interest, would be paid to the beneficiaries. What is the taxable income attributable to Mrs. Allen for the year from the trust?

- \$12,000.
  - \$12,500.
  - \$15,800.
  - \$15,000.
  - \$13,800.
24. Upon his death three years ago, Mr. Tajima's will provided for the creation of a trust with his four children as beneficiaries. During 2016, the trust's income consisted of interest received from Canadian sources of \$20,000. For 2016, the trustees jointly agreed that all income received by the trust, except for the following two amounts would be paid to the beneficiaries.

Interest income retained by the trust	\$8,000
Share of interest allocated to a 5 year old beneficiary that will be paid when he turns 18	\$3,000

In addition, the trust designated the share of one beneficiary to be not paid, even though the beneficiary received the payment. The amount was \$5,000. What is the Net Income For Tax Purposes of the trust?

- \$11,000.
  - \$13,000.
  - \$16,000.
  - \$20,000.
25. Which of the following statements is correct with respect to the preferred beneficiary election?
- This election is available for beneficiaries that are eligible for the disability tax credit, or who are eligible to be claimed by another individual for either the infirm dependent over 17 credit or the caregiver credit.
  - A trust cannot deduct amounts that are paid or payable to a preferred beneficiary.
  - A trust can deduct amounts allocated to, but not distributed to, a preferred beneficiary.
  - The preferred beneficiary election is used when the trust wants to allocate 100% of its income to a particular beneficiary for one year.

***Income Allocations to Beneficiaries***

26. The Weir family trust is an inter vivos trust with one beneficiary. The beneficiary is 25 year old Marcus Weir, the son of the settlor. During 2016, the trust had the following income:

Eligible dividends from publicly traded Canadian corporations	\$ 50,000
Non-eligible dividends from a family owned CCPC	200,000
Capital gain from share sale	30,000

The non-eligible dividends and capital gain are distributed to Marcus. By how much will Marcus' Net Income for Tax Purposes increase as a result of this distribution?

- A. \$249,000.
- B. \$291,000.
- C. \$215,000.
- D. \$265,000.

***Tax Payable Of Personal Trusts (GREs)***

27. On the death of Martin Meryk, his shares in Meryk Limited, a CCPC, were transferred to a graduated rate estate (GRE). During 2016, the GRE receives non-eligible dividend income from Meryk Limited in the amount of \$200,000. Martin's will requires that one-half of the dividends be distributed to his wife, Marta with the remainder retained in the GRE. Marta has no income other than what she receives from the trust. Which of the following statements is correct?

- A. The federal tax payable is the same for Marta and the GRE.
- B. The Taxable Income is the same for Marta and the GRE.
- C. The federal dividend tax credit is available to Marta, but not to the GRE.
- D. The income retained in the GRE is taxed at a federal rate of 33 percent.

***Income Attribution***

28. On January 1 of the current year, Mandeep Gill transferred interest earning securities with a cost of \$95,000 and a fair market value of \$250,000 to a family trust for no consideration. One-half of the income of the trust is allocated to his 12 year old son, and the other half to his wife. The trust earns \$7,000 in interest income during the year. What will the tax consequences of these transactions be to Mandeep?

- A. Mandeep will have a taxable capital gain of \$77,500 and will have attributed interest income of \$7,000.
- B. Mandeep will not report a taxable capital gain on the transfer, but the interest income of \$7,000 will be attributed to him.
- C. Mandeep will have a taxable capital gain of \$77,500. No interest income will be attributed to him.
- D. Mandeep will have a taxable capital gain of \$77,500 and the interest income allocated to Mrs. Gill of \$3,500 will be attributed to him.

**Purchase Or Sale Of An Interest In A Trust**

29. The Ali family trust was established when Mrs. Ali transferred publicly traded securities with a cost of \$100,000 and a fair market value of \$250,000 into the trust. The beneficiaries are Mrs. Ali's 30 year old twin daughters, Aida and Fatima. They benefit equally from the income and the capital of the trust. In the current year, Aida purchased Fatima's capital interest from her for its fair market value of \$350,000 [(1/2)(\$700,000)]. The tax consequences of this transaction to Aida and Fatima are:
- A. Aida has acquired a capital interest in the trust with an adjusted cost base of \$350,000. Fatima will report a taxable capital gain of \$112,500.
  - B. Aida has acquired a capital interest in the trust with an adjusted cost base of \$350,000. Fatima will report a taxable capital gain of \$175,000.
  - C. Aida has acquired a capital interest in the trust with an adjusted cost base of nil. Fatima will report a taxable capital gain of \$175,000.
  - D. Aida has acquired a capital interest in the trust with an adjusted cost base of \$350,000. Fatima will report a taxable capital gain of \$50,000.

**Tax Planning**

30. Ferran Ginton has operated a very successful bakery for 30 years, and has accumulated securities that earn interest income of \$40,000 per year. His other sources of income put him in the top tax bracket for personal tax purposes. He has a son, Habib who is 22 years old and currently has no income that is subject to taxation. Habib's only tax credit is the personal tax credit. Determine the amount of federal taxes that could be saved by transferring the interest earning securities to a trust with Habib as the income beneficiary, assuming that the trust will be required to distribute all of its income each year.
- A. \$7,200.
  - B. \$8,921.
  - C. \$4,279.
  - D. \$11,479.
31. Which of the following is **NOT** a valid reason for using an alter ego trust?
- A. An alter ego trust removes property from the estate of the settlor, and these assets will not be subject to probate procedures on the death of the settlor.
  - B. The trust could be established in a low rate province resulting in a tax savings on the death or emigration of the settlor.
  - C. The trust will be subject to lower tax rates, and can be used to split income with the settlor.
  - D. If all assets have been transferred to an alter ego trust prior to the death of the settlor, the settlor does not need to leave a will, which could be easily challenged. It is not as easy to challenge the validity of a trust.

**Estate Freeze**

32. What is the objective of an estate freeze?
- A. To freeze certain family members out of participation in a large estate.
  - B. To allow future appreciation in valuable assets to appreciate for the benefit of specific related parties.
  - C. To delay the transfer of income generating private company shares to minor children to avoid the tax on split income.
  - D. To allow a wealthy taxpayer to transfer valuable assets to the next generation without tax consequences.

33. An estate freeze can be accomplished by various techniques. Which of the following techniques will **NOT** involve immediate tax consequences at the time of the freeze?
- A. A gift to an individual's children of capital assets with accrued gains.
  - B. A transfer of capital assets with accrued gains to a corporation using ITA 85.
  - C. A transfer of capital assets with accrued gains to a trust with the transferor's children as beneficiaries.
  - D. A transfer of capital assets with accrued gains to a holding company in which the individual's children are the majority shareholders.
34. An estate freeze can be implemented using either ITA 85 or ITA 86. Which of the following is an advantage of using ITA 85, rather than ITA 86?
- A. The use of ITA 85 does not require an election.
  - B. The use of ITA 85 does not require a corporation to be in place prior to the freeze.
  - C. The use of ITA 85 will significantly reduce the legal and accounting costs of the freeze.
  - D. The use of ITA 85 does not involve an exchange of shares.

## TIF PROBLEM NINETEEN - 4

### Trusts - Exam Exercises

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#### *Exam Exercise Subject Listing For Chapter 19*

<b>Number</b>	<b>Subject</b>
1	Establishing A Trust
2	Basic Taxation Of Trusts
3	Basic Taxation Of Trusts
4	Transfers To Common-Law Partner Trusts
5	Transfers To Common-Law Partner Trusts
6	Transfers To Trusts
7	Transfers To Trusts
8	Spousal Trusts And Income Allocation
9	Spousal Trusts And Income Allocation
10	Flow Through To Beneficiaries
11	Flow Through To Beneficiaries
12	Inter Vivos Trusts - Tax Payable
13	Inter Vivos Trusts - Tax Payable
14	Testamentary Trusts - Tax Payable
15	Income Attribution
16	Income Attribution
17	Sale Of A Capital Interest
18	Sale Of A Capital Interest
19	Family Trusts
20	Family Trusts

**Exam Exercise Nineteen - 1 (Establishing A Trust)**

In each of the following Cases, an individual is attempting to establish a trust. For each of these Cases, indicate whether the attempt has been successful. Explain your conclusion.

**Case A** Martin Falk has signed an agreement that specifies the property that he will transfer to a trustee at the end of the current year. The income from the trust will be distributed to his friend of several years, Lola Lamour.

**Case B** Martha Stuart transfers property to a trustee, specifying that the income from the property should be distributed to prison inmates in Virginia.

**Case C** Joan Morgan sends a cheque to her son, indicating that the money should be used for the education of her grandchildren.

**Exam Exercise Nineteen - 2 (Basic Taxation Of Trusts)**

On January 1, 2016, Jerry Fallen transfers debt securities with a fair market value of \$570,000 to a newly established inter vivos trust for which his 22 year old son, James, is the only beneficiary. The cost of these securities to Jerry was \$520,000. During 2016, the securities earn and receive interest of \$32,000, all of which is distributed to James.

On January 1, 2017, the securities are transferred to James in satisfaction of his capital interest in the trust. At this time, the fair market value of the securities has increased to \$615,000. James sells all of the securities for \$615,000 on January 3, 2017.

Indicate the tax consequences for Jerry, James, and the trust, in each of the years 2016 and 2017.

**Exam Exercise Nineteen - 3 (Basic Taxation Of Trusts With Income Attribution)**

At the beginning of 2016, Martha Stuart transfers a group of common stocks to a trust that has her 15 year old daughter Jane as the only beneficiary. The securities have an adjusted cost base of \$350,000 and a fair market value of \$500,000. During 2016, the securities pay eligible dividends of \$50,000, all of which are distributed to Jane.

At the beginning of 2017, all of the securities are transferred to Jane in satisfaction of her capital interest. At this time their fair market value is \$550,000. Jane immediately sells the securities for this amount.

Indicate the tax consequences for Martha, Jane, and the trust, in each of the years 2016 and 2017.

**Exam Exercise Nineteen - 4 (Transfer To Common-Law Partner Trust)**

Larry died during 2016 and bequeathed a portfolio of equity securities to a qualifying common-law partner trust created in his will. Larry is survived by his common-law partner, David who is to receive the securities from the trust three years after Larry's death if they have not been sold. The portfolio, which had an adjusted cost base of \$420,000, was valued at \$723,000 on the date of his death.

Determine the tax consequences of the transfer, including the adjusted cost base of the portfolio in the trust and in David's hands if it is transferred.

**Exam Exercise Nineteen - 5 (Transfer To Common-Law Partner Trust)**

Lara Jensen was living with her common-law partner Portia at the time of her death in 2016. Lara's will established a group of equity securities that were to be transferred to a qualifying common-law partner trust. The securities had an adjusted cost base of \$675,000 and a fair market value of \$850,000 at the time of transfer. The securities are to be transferred to Portia five years after the date of Lara's death.

What are the tax consequences to Lara of the transfer made at the time of her death? What would be the tax consequences to Portia if, after she receives the securities from the trust, she sells them for \$950,000?

**Exam Exercise Nineteen - 6 (Transfers To Trusts)**

An individual has property with a cost of \$2,100 and a current fair market value of \$2,500. Seven Scenarios are presented for the transfer of this property by the settlor to a trust. For each Scenario, indicate the tax consequences to the settlor at the time of transfer, as well as the adjusted cost base of the property within the trust.

- Scenario 1: Transfer to inter vivos trust for adult child.
- Scenario 2: Transfer to testamentary qualifying spousal trust.
- Scenario 3: Transfer to joint common-law partner trust.
- Scenario 4: Transfer to inter vivos qualifying spousal trust.
- Scenario 5: Transfer to inter vivos trust for minor child.
- Scenario 6: Transfer to testamentary trust for friend.
- Scenario 7: Transfer to alter ego trust.

**Exam Exercise Nineteen - 7 (Transfers To Trusts)**

Ian Home has a property that he purchased several years ago for \$20,000. It has a current fair market value of \$30,000.

The following Six Scenarios are proposed for the transfer of this property by Ian to a trust. For each Scenario, indicate the tax consequences to Ian at the time of transfer, as well as the adjusted cost base of the property within the trust.

- Scenario 1: Transfer to joint spousal trust.
- Scenario 2: Transfer to inter vivos trust for a business partner.
- Scenario 3: Transfer to testamentary trust for a 22 year old son.
- Scenario 4: Transfer to testamentary qualifying spousal trust.
- Scenario 5: Transfer to an alter ego trust.
- Scenario 6: Transfer to an inter vivos trust for a minor child.

**Exam Exercise Nineteen - 8 (Spousal Trusts And Income Allocation)**

Five years ago, a depreciable asset was transferred from Mark's estate to a qualifying spousal trust created on his death. The asset, which cost \$224,000, had a UCC of \$147,200 at the time of transfer. At the time of Mark's death, the asset had a fair market value of \$262,400. Since then, the trust has claimed CCA of \$15,400. At the end of the current year, the trust sold the asset to an arm's length party for \$243,200.

Determine the tax consequences of the transfer of the asset to the spousal trust and of the disposition of the asset by the trust. Determine the maximum amount of trust income that can be allocated to Mark's spouse from the sale.

**Exam Exercise Nineteen - 9 (Spousal Trusts And Income Allocation)**

Martine Flex died three years ago. At the time of her death, a depreciable asset was transferred from her estate to a qualifying spousal trust that was created on her death. The asset had a capital cost of \$150,000 and it was the only asset in its class. The balance in the class was \$140,000. At the time of Martine's death, the asset had a fair market value of \$180,000.

Since that time, the trust has claimed CCA on the asset of \$20,000. At the end of the current year, the asset is sold to an arm's length party for \$205,000.

Determine the tax consequences of the transfer of the asset to the spousal trust and of the disposition of the asset by the trust. Determine the maximum amount of trust income that can be allocated to Martine's spouse from the sale.

**Exam Exercise Nineteen - 10 (Flow Through To Beneficiaries)**

During the year ending December 31, 2016, the Renaud family trust received eligible dividends from publicly traded Canadian corporations in the amount of \$367,000. In addition, it received non-eligible dividends from the family owned Canadian controlled private corporation in the amount of \$108,000. Its only other source of 2016 income was a capital gain of \$47,000 on a disposition of investments in publicly traded equity securities.

The only beneficiary of the trust is the family's 23 year old daughter, Francine Renaud. During 2016, \$210,000 of the dividends from public companies, all of the dividends from the family's private company, and all of the \$47,000 capital gain were distributed to Francine.

Indicate the tax effects of these transactions on the 2016 Net Income For Tax Purposes for both the trust and for Francine. In addition, calculate the federal dividend tax credit available to both the trust and Francine for 2016.

**Exam Exercise Nineteen - 11 (Flow Through To Beneficiaries)**

The Weryk family trust is an inter vivos trust with one beneficiary. The beneficiary is 25 year old Marcin Weryk, the son of the settlor. During 2016, the trust received eligible dividends of \$50,000 from publicly traded Canadian corporations. In addition, the trust received \$200,000 in non-eligible dividends from a family owned CCPC. The trust sold shares in a public company, resulting in a capital gain of \$30,000. Seventy-five percent of both the trust's current year income and capital gains was distributed to Marcin.

Determine the effect of these transactions on the Net Income For Tax Purposes for both the trust and for Marcin.

**Exam Exercise Nineteen - 12 (Inter Vivos Trusts - Tax Payable)**

The sole income receipt for 2016 of an inter vivos trust is \$35,500 in non-eligible dividends received from a private Canadian corporation. The only beneficiary of the trust is the adult son of the settlor. The beneficiary was paid \$24,500 from the dividend income, which also was his sole income for the year. He has no personal tax credits other than the basic personal tax credit and any credits related to his trust income.

Calculate the Taxable Income and federal Tax Payable for 2016 for both the trust and for the beneficiary.

**Exam Exercise Nineteen - 13 (Inter Vivos Trusts - Tax Payable)**

The Fonda family trust is an inter vivos trust with one beneficiary, Liana, the 25 year old daughter of the settlor, Mr. Fonda. Liana has no income other than what she receives from the trust, and has no personal tax credits other than the basic personal tax credit and any credits related to her trust income. The trust receives eligible dividend income of \$100,000 in 2016 and does not distribute any of the dividends to Liana. Determine federal Tax Payable for the trust for 2016.

**Exam Exercise Nineteen - 14 (Testamentary Trusts - Tax Payable)**

Martin Weryk died on January 1, 2016. While all of his estate will eventually be transferred to his wife, Marta Weryk, on December 31, 2016, a significant portion of the assets are still under the administration of his executor.

The executor files a T3 return for the year ending December 31, 2016, designating the estate as a Graduated Rate Estate (GRE). The estate's income during the period January 1 to December 31, 2016 consists of non-eligible dividends in the amount of \$200,000. Martin's will stipulates that while the estate is being administered by the executor, 50 percent of its income is to be distributed to his wife Marta, with the balance accumulating in the estate. As per these instructions, \$100,000 of the non-eligible dividends received are paid to Marta on December 31, 2016. Marta's only tax credits are the basic personal credit, the age credit and any credits related to her trust income.

Determine the 2016 federal Tax Payable for both Marta and the trust.

**Exam Exercise Nineteen - 15 (Income Attribution)**

Last year, Martine Brown transferred to a family trust, for no consideration, bonds that pay interest of \$108,000 per annum. The beneficiaries of the trust are Martine's spouse, Michael, and their two children, Rachel (16 years old) and Dirk (22 years old). The beneficiaries have no income other than that from the trust. The trust income and capital gains are allocated equally, and are payable to each beneficiary during the year. Total interest income earned by the trust during the year was \$108,000. As well, a capital gain of \$36,000 was realized on the trust's disposition of one of the bonds that Martine Brown transferred into the trust.

Determine the Taxable Income of each beneficiary and calculate any effect the trust income will have on the Taxable Income of Martine.

**Exam Exercise Nineteen - 16 (Income Attribution)**

In 2016, Devon Jenkins transferred to a family trust, for no consideration, publicly traded stocks that paid eligible dividends of \$72,900 to the trust during the year ending December 31, 2016. The beneficiaries of the trust are Devon's spouse, Connie, and their two children, Marvin (16 years old) and Diane (22 years old). The beneficiaries have no income other than that from the trust. During 2016, the trust income and capital gains are allocated equally, and are payable to each beneficiary during the year. In addition to the dividends, there was a 2016 disposition of shares held by the trust that resulted in a capital gain of \$16,200.

Determine the Taxable Income of each beneficiary and calculate any effect the trust income will have on the Taxable Income of Devon.

**Exam Exercise Nineteen - 17 (Sale Of A Capital Interest)**

The Barton family trust was established when Mrs. Barton transferred publicly traded securities with a cost of \$187,000 and a fair market value of \$312,000 into the trust. The beneficiaries of the trust are Mrs. Barton's two daughters, Sarah, aged 25, and Mary, aged 27. They have an equal interest in the income and capital of the trust.

At the beginning of the current year, Mary sells her capital interest in the trust to Sarah. There have been no capital distributions from the trust. At the time of the sale, the fair market value of the securities in the trust is \$409,000. Based on this, the transfer price for the capital interest is \$204,500  $[(1/2)(\$409,000)]$ .

Determine the tax consequences of this transaction to each of the sisters.

**Exam Exercise Nineteen - 18 (Sale Of A Capital Interest)**

At the beginning of 2016, Connie McGuire transferred publicly traded stocks to a family trust. Connie's adjusted cost base for these shares was \$240,000 and they had a fair market value at the time of transfer of \$300,000. The trust's beneficiaries are Connie's two sons, Bart and Billy. They are both in their early 30s.

During the remainder of 2016, the stocks paid eligible dividends \$38,000, all of which were distributed to the two beneficiaries during the year. There are to be no capital distributions from the trust for 5 years.

In early 2016, Bart sells his interest to Billy. At that time, the securities have a fair market value of \$420,000. Based on this, Bart pays \$210,000 to Billy for his interest.

Determine the tax consequences of this transaction to each of the brothers.

**Exam Exercise Nineteen - 19 (Family Trusts)**

Fred Kemper is holding debt securities which produce interest income of \$150,000 per year. He has other sources of income in excess of \$300,000. He has three sons who are triplets. They are 25 years old and currently have no income that is subject to tax. Their only tax credit is the basic personal credit.

Determine the savings in federal taxes that could be achieved by transferring the debt securities to a family trust with the triplets as equal income beneficiaries. The trust will be required to distribute all of its income on an annual basis.

**Exam Exercise Nineteen - 20 (Family Trusts)**

Darlene Knight has employment income in excess of \$250,000 per year. In addition, she has a portfolio of debt securities that are producing interest income of \$120,000. The fair market value of the debt securities is equal to their adjusted cost base.

Darlene has two sons, both of whom are over 18 years of age. However, they have no income of their own and continue to live at home. Their only tax credit is the basic personal credit.

Determine the savings in federal taxes that could be achieved by transferring the debt securities to a family trust with the two sons as equal income beneficiaries. The trust will be required to distribute all of its income on an annual basis.

## **TIF PROBLEM NINETEEN - 5A**

### **Trusts - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 19, “Trusts And Estate Planning”.

- A. Joint Spousal Trust
- B. Personal Trust
- C. Reversionary Trust
- D. Settlor
- E. Spousal Or Common-Law Partner Trust
- F. Alter Ego Trust
- G. Testamentary Trust
- H. Trustee

The following list contains ten potential definitions for the preceding key terms.

1. A testamentary or inter vivos trust in which no beneficial interest was acquired for consideration paid to the trust or to a person who contributed property to the trust.
2. A trust agreement under which the property held by the trustee can revert to the settlor.
3. A trust that is not a testamentary trust.
4. A trust that arises on, and as a consequence of, the death of an individual.
5. A person appointed by an individual in his/her will to oversee the administration of the estate on his/her death in accordance with the terms of that will.
6. The individual who creates a trust by contributing property to be managed and administered by a trustee for the beneficiaries.
7. An inter vivos or testamentary trust that has an individual’s spouse or common-law partner as a beneficiary.
8. An inter vivos trust established by an individual aged 65 years or more, subject to the conditions that the individual must be entitled to all of the trust’s income during his lifetime, and the individual must be the only person who can access the capital of the trust during his lifetime.
9. An inter vivos trust established by an individual aged 65 years or more, subject to the conditions that the individual and his/her spouse or common-law partner must be entitled to all of the trust’s income during their lifetimes, and the individual and his spouse or common-law partner must be the only individuals who can access the capital of the trust during his/her lifetime.
10. An individual or trust institution that holds legal title to property in trust for the benefit of the trust beneficiaries.
11. None of the above definitions apply. (This answer can be used more than once.)

**TIF Problem Nineteen - 5A**  
*Trusts - Key Term Matching (Easy)*

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 11) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply. Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM NINETEEN - 5B**

### **Trusts - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 19, "Trusts And Estate Planning".

- A. Joint Spousal Trust
- B. Personal Trust
- C. Reversionary Trust
- D. Settlor
- E. Spousal Or Common-Law Partner Trust
- F. Alter Ego Trust
- G. Testamentary Trust
- H. Trustee

The following list contains 14 potential definitions for the preceding key terms. There is also a "none of the above" designation.

1. A testamentary or inter vivos trust in which no beneficial interest was acquired for consideration paid to the trust or to a person who contributed property to the trust.
2. An individual who gives property to a specified group of beneficiaries.
3. A trust agreement under which the property held by the trustee can revert to the settlor.
4. A trust that is not a testamentary trust.
5. A trust that arises on, and as a consequence of, the death of an individual.
6. A person appointed by an individual in his/her will to oversee the administration of the estate on his/her death in accordance with the terms of that will.
7. The individual who creates a trust by contributing property to be managed and administered by a trustee for the beneficiaries.
8. An inter vivos or testamentary trust that has an individual's spouse or common-law partner as a beneficiary.
9. A trust that is created by the will of an individual.
10. An inter vivos trust established by an individual aged 65 years or more, subject to the conditions that the individual must be entitled to all of the trust's income during his lifetime, and the individual must be the only person who can access the capital of the trust during his lifetime.
11. A trust in which all of the beneficiaries are individuals.

**TIF Problem Nineteen - 5B**  
*Trusts - Key Term Matching (Moderate)*

12. An inter vivos trust established by an individual aged 65 years or more, subject to the conditions that the individual and his/her spouse or common-law partner must be entitled to all of the trust's income during their lifetimes, and the individual and his spouse or common-law partner must be the only individuals who can access the capital of the trust during his/her lifetime.
13. A trust agreement under which the property held by the trustee must revert to the settlor.
14. An individual or trust institution that holds legal title to property in trust for the benefit of the trust beneficiaries.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM NINETEEN - 6**

### **Property Transfers To And From A Trust**

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Each of the following independent Cases involve transfers of property to trusts by a settlor for no consideration. Two of the Cases also involve capital distributions from trusts to capital beneficiaries.

- A. A gift of depreciable capital property is made to 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 fair market value was \$26,400.
- B. A gift of depreciable capital property is made to 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 property had a UCC of \$12,400, and a fair market value of \$15,200. At a later time, when the property is distributed to a capital beneficiary, the property has a UCC of \$13,600 and a fair market value of \$17,600.
- C. A transfer of non-depreciable capital property is made to a qualifying spousal testamentary trust. The cost of the capital property to the deceased spouse was \$18,200, and the fair market value on the date of the transfer to the trust is \$76,400. At the time of his death, the decedent had net capital loss carry forwards in excess of \$91,500.
- D. A gift of non-depreciable capital property is made to an inter vivos trust in favour of the settlor's adult children. The adjusted cost base of the property to the settlor was \$85,400. Its fair market value on the date of the gift is \$123,200.
- E. A gift of non-depreciable capital property is made to an inter vivos trust in favour of the settlor's adult children. The adjusted cost base of the property to the settlor was \$43,200. On the date of the gift, the property had a fair market value of \$51,600. At a later time, when the value of the property has increased to \$61,400, this property is distributed to a capital beneficiary of the trust.
- F. Capital property is transferred to an alter ego trust. The cost of the capital property to the settlor was \$14,200 and the fair market value on the date of the transfer is \$23,100.

**Required:** For each Case indicate:

- 1. The tax consequences to the settlor that result from the transfer of property to the trust assuming the transfer price is chosen to optimize the tax position of the settlor.
- 2. The tax value(s) for the transferred property that will be recorded by the trust.
- 3. In those cases where property is transferred to a beneficiary, the tax consequences to the trust and the tax value(s) that will be recorded by the beneficiary.

## **TIF PROBLEM NINETEEN - 7**

### **Trusts And Income Splitting**

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Genevieve Marcoux is a biochemist who annually earns a \$250,000 salary. In addition, she has \$40,000 in investment income from an \$800,000 term deposit she inherited.

Genevieve is a single mother with two children. Her daughter, Lisa, is 21 years old and attends university in the U.S. Lisa plans to become a medical doctor and expects to attend university for another seven years. Lisa's tuition and books cost \$30,000 (Canadian) each year. Genevieve's son, Philip, is one year old, and is cared for by a nanny who is paid \$14,500 a year.

When Philip is five years old, Genevieve intends to send him to a private school, and the fees will be comparable to the cost of a nanny. In addition, Genevieve incurs \$500 each month in direct expenses for each child, totaling \$12,000 a year. Genevieve does not expect either Lisa or Philip to earn any Taxable Income until they complete university.

Genevieve would like to transfer the term deposit to a trust for her children, so the family can benefit from income splitting currently, and in the future. While she supports her children fully, she does not want them to receive any cash directly from the trust until they are each 35 years old. Until then, she wants the trust to pay for their care, education, and other direct expenses.

**Required:** Outline how a trust might be used to split income among Genevieve's family members.

## **TIF PROBLEM NINETEEN - 8**

### **Inter Vivos Trusts - Tax Payable**

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Ms. Sally Jurgens is a very successful advertising executive. About 10 years ago, she transferred a large group of investments into a trust in favour of her two children. The fiscal 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 percent of all of the income of the trust, while her son Joseph is to receive 40 percent of this income. Jessica is aged 32 while Joseph is 28. Both children are single and have no current sources of income other than the trust.

The undistributed income is to accumulate within the trust, to be paid out to the children at the time of Ms. Jurgens' death.

The income figures for the year ending on December 31, 2016, are as follows:

Interest Income On GICs	\$126,000
Eligible Dividends Received From Canadian Corporations	462,000
Revenues From Rental Property	125,000
Cash Expenses On Rental Property	83,000

On October 1, 2016, the rental property was sold. The property consisted of an apartment building and the land on which it was located, all of which was transferred into the trust when it was established. The relevant information related to the disposition is as follows:

	<b>Building</b>	<b>Land</b>
Proceeds Of Disposition	\$962,000	\$250,000
Undepreciated Capital Cost	627,000	N/A
Capital Cost/Adjusted Cost Base	725,000	85,000

This is the first disposition of capital property by the trust since its establishment.

**Required:**

- A. Calculate the Taxable Income of the trust, Jessica Jurgens, and Joseph Jurgens for the year ending December 31, 2016.
- B. Calculate the federal Tax Payable for the trust, for the year ending December 31, 2016.

**TIF PROBLEM NINETEEN - 9****Graduated Rate Estates - Transfers and Tax Payable**

Mary Staple died on March 31, 2016. Under the terms of her will, all of her property will be transferred to a trust in favour of her two children, 27 year old Mac and 22 year old Muff.

For various reasons, on December 31, 2016, Mary's estate has not yet been transferred to the trust and the estate assets are still under the administration of her executor. The executor files a T3 tax return for the fiscal period ending on December 31, 2016 designating Mary's estate as a Graduated Rate Estate (GRE). While the executor could have chosen a non-calendar taxation year, he decided to use December 31 as the year end for the GRE.

Information on the property owned by Mary at her death is as follows:

	<b>Tax Cost</b>	<b>Fair Market Value March 31, 2016</b>
Public Company Shares	\$1,420,000	\$2,156,000
Government Of Canada Bonds	562,000	562,000
Rental Property		
Land	622,000	787,000
Building (Cost = \$850,000)	684,000	1,230,000

Between March 31 and December 31, 2016, the following income and expense amounts were recorded by the trust:

Eligible Dividends Received		\$ 85,000
Interest On Bonds		17,000
Net Rental Income:		
Rental Revenues	\$132,450	
Rental Expenses Other Than CCA	( 31,500)	
CCA Claimed	( 23,400)	77,550
<b>Total Income</b>		<b>\$179,550</b>

In keeping with the terms specified in Mary's will, the executor distributes 30 percent of the GRE's income to Mac and 40 percent to Muff, leaving 30 percent in the GRE.

**Required:**

- Determine the increase in Net Income For Tax Purposes that will result from Mary's death.
- For the fiscal period ending on December 31, 2016, determine the Taxable Income for the GRE and the total Taxable Income allocated to each beneficiary.
- Calculate the federal Tax Payable for the GRE for the fiscal period ending on December 31, 2016.

## **TIF PROBLEM NINETEEN - 10**

### **Inter Vivos Trusts - Tax Payable**

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Last year, Mr. Jerry Hall established an inter vivos trust for his 22 year old son, Mark Hall. The trust agreement leaves to the discretion of the trustees the portion of each type of the trust's income that will be distributed each year. During the year ending December 31, 2016, the following amounts of income were earned by the assets in the trust:

Interest From Canadian Sources	\$ 18,500
Capital Gains	43,000
Eligible Dividends Received From Canadian Corporations	32,000
Net Rental Income (After CCA Deduction Of \$4,300)	19,500
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Total Trust Income	\$113,000
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During 2016, the trustees distributed all of the interest to Mark, as well as 80 percent of the capital gains, dividends, and net rental income.

Mark is a full time student for 12 months during 2016 and his tuition for the year was \$12,500. He has no other source of income during this year.

**Required:** Calculate Taxable Income and federal Tax Payable for the year ending December 31, 2016, for both the trust and for Mark. In addition, comment on whether it was advantageous for the trustees to leave 20 percent of the capital gains, dividends, and net rental income in the trust.

**TIF PROBLEM NINETEEN - 11****Graduated Rate Estates - Transfers and Tax Payable**

After a long illness, Marlene Scopal passed away on April 4, 2016. Her will requires that all of the assets of her estate be transferred to a testamentary trust with her two children, Marilyn, her 32 year old daughter and Murphy, her 24 year old son as beneficiaries. However, because of complications in making the transfer to the trust, on December 31, 2016, the estate assets are still under the administration of her executor.

The executor files a T3 tax return, designating Marlene's estate as a Graduated Rate Estate (GRE) for the fiscal period ending on December 31, 2016. While the executor could have chosen a non-calendar taxation year, he decided to use December 31 as the year end for the GRE.

The information on the property owned by Marlene at her death is as follows:

	<b>Tax Cost</b>	<b>Fair Market Value April 4, 2016</b>
Public Company Shares	\$1,856,000	\$2,342,000
Government Of Canada Bonds	562,000	562,000
Rental Property		
Land	865,000	989,000
Building (Cost = \$1,250,000)	932,000	1,560,000

As Marlene anticipated difficulty in transferring some of her assets to the testamentary trust, her will indicated that any income that accrues to her estate prior to that transfer should be distributed 35 percent to Marilyn and 45 percent to Murphy, with the remaining 20 percent allowed to accumulate in the GRE.

Between April 4, 2016 and December 31, 2016, the following income and expense amounts were recorded by the GRE:

Eligible Dividends Received		\$123,670
Interest On Bonds		22,490
Net Rental Income:		
Rental Revenues	\$192,460	
Rental Expenses Other Than CCA	( 49,450)	
CCA Claimed	( 42,100)	100,910
<b>Total Income</b>		<b>\$247,070</b>

**Required:**

- Determine the increase in Marlene's 2016 Net Income For Tax Purposes that will result from her death.
- For the fiscal period ending on December 31, 2016, determine the Taxable Income for the GRE and the total Taxable Income allocated to each beneficiary.
- Calculate the federal Tax Payable for the GRE for the fiscal period ending on December 31, 2016.

## **Chapter Twenty Test Item File Problems**

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### **TIF PROBLEM TWENTY - 1**

#### **International Income - Essay Questions**

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1. List two objectives that are served by international tax treaties.
2. What is the importance of residence in Canadian income taxation?
3. When an individual leaves Canada, the CRA may take the position that he has retained his residence status. What are the primary factors that the CRA will consider in determining whether such an individual has, in fact, ceased to be a Canadian resident?
4. List three factors that would be considered in the determination of whether or not an individual is a resident of Canada.
5. If an individual leaves Canada for a temporary absence, this raises the question of whether he was a Canadian resident during the period of absence, particularly if some residential ties have been retained. What are the major factors that are considered in determining whether an individual continues to be a Canadian resident during a temporary absence?
6. One of your friends is leaving Canada and would like to know when he will no longer be considered a Canadian resident. Briefly explain the rules related to terminating an individual's status as a Canadian resident.
7. For the current year, Jane Doe is deemed to a Canadian resident because she sojourned in Canada for 210 days. Also for the current year, Jack Fawn, a long-time resident of Manitoba, was considered a part year resident for the first 210 days, after which he permanently departed from Canada. Explain how these two individuals will be taxed in Canada.
8. It is possible that an individual could be considered resident in more than one country. In such situations, "tie-breaker" rules are used to avoid the individual being subject to taxation in both countries. List and describe three factors that would be considered in implementing the tie-breaker rules.
9. Are enterprises that are incorporated in Canada always considered to be resident in Canada? Explain your conclusion.
10. Limon Inc. was incorporated in the U.S. five years ago. However, all of the directors of the corporation are Canadian residents, holding all of their meetings in Montreal. How would Limon Inc. be taxed?
11. Indicate the types of income on which non-residents are subject Canadian Part I taxes.
12. In general, employment income earned in Canada is subject to Part I tax. However, the Canada/U.S. tax treaty provides exceptions to this general rule. Describe these exceptions.
13. The Canada/U.S. tax treaty permits Canadian taxation of business income earned by a U.S. business that has a "permanent establishment" in Canada. The treaty also indicates that, in some situations, an individual can be considered to be a permanent establishment for the purposes of this rule. Describe these situations.
14. Provide two examples of the type of income on which Part XIII tax is assessed.

15. A non-resident individual owns a rental property in Canada. While her rental revenues would be subject to Part XIII tax, as an alternative, she can elect to pay taxes under Part I, rather than Part XIII. Why might she wish to make this election?
16. When an individual immigrates to Canada, there is a deemed disposition/reacquisition at fair market value of most of their capital property. Briefly explain why this is an important provision for most individuals.
17. When a person emigrates from Canada, there is no deemed disposition/reacquisition of their Canadian real estate holdings. However, ITA 128.1(4)(d) allows a taxpayer to elect to have a deemed disposition/reacquisition of real estate at the time of their departure. Why would an individual wish to make this election? Briefly explain your conclusion.
18. An individual emigrates from Canada at a time when he owns shares in a private company with a fair market value of \$500,000 and an adjusted cost base of \$300,000. Two years later, he decides to return to Canada. At this time he still owns the shares. What are the tax consequences of his departure from Canada and his return to Canada.
19. John Barth has \$20,000 of foreign source business income, from which the government in the foreign jurisdiction has withheld \$2,000. Briefly describe the treatment of the withholding amount in determining John Barth's Canadian Tax Payable.
20. Explain why dividends received by individuals from non-resident corporations do not usually receive the same gross up and tax credit treatment that is accorded to dividends received from taxable Canadian corporations.
21. Summarize the taxation of the income of controlled and non-controlled foreign affiliates.
22. Clarkson Equipment Ltd. is a manufacturer of construction equipment that is used throughout the world. The factory is located in Windsor, Ontario and the majority of its manufacturing operations take place at that location. In the current year, the Company negotiated a very significant contract with an African country with which Canada has a comprehensive tax treaty. The contract requires not only the provision of the Company's equipment, but instruction and training of the operators as well. Given the magnitude of this contract, Clarkson is considering establishing a subsidiary in the African country to carry out the terms of the agreement. Compare the Canadian tax treatment of income earned if the contract was handled through the Canadian head office with the tax treatment if a non-resident subsidiary is used to carry out the contract.

## **TIF PROBLEM TWENTY - 2**

### **International Income - True Or False**

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1. If there is a conflict between the Canadian *Income Tax Act* and the Canada/U.S. tax treaty, the provisions of the treaty must be used.  
True or False?
2. When an individual is absent from Canada for some period of time, the length of their absence is an important factor in determining whether they continued to be a Canadian resident during the period of their absence.  
True or False?
3. If an individual moves to Canada and is here less than 183 days prior to the end of the year, that individual will be subject to Part I tax on their world wide income for the entire year.  
True or False?
4. The residency of a trust depends on the country in which the central management and control of the trust takes place, not where the beneficiaries reside.  
True or False?
5. If a non-resident individual has Part I Tax Payable and is required to file a Canadian tax return, he will not be eligible for any of the usual credits against the total amount payable.  
True or False?
6. The Canada/U.S. tax treaty allows Canada to tax the business income of U.S. residents, provided that business is operated in Canada through a permanent establishment.  
True or False?
7. If a U.S. resident earns less than than \$10,000 in Canadian employment income, the employment income will not be taxed in Canada even if the income is paid by a Canadian business that deducts the payments.  
True or False?
8. If a non-resident is required to pay Part XIII tax in Canada, they will have to file a Canadian tax return.  
True or False?
9. If a U.S. resident receives interest on Canadian participating debt, she will be required to pay Part XIII tax on the amounts received.  
True or False?
10. If a Canadian citizen emigrates to the U.S., he will have a deemed disposition of all of his Canada capital property.  
True or False?

11. If an individual leaves Canada, the three most significant factors in determining whether he has ceased to be a resident are:

- Whether he continues to own a dwelling in Canada.
- Whether he is accompanied by his spouse or common-law partner.
- Whether he maintains social ties in Canada.

True or False?

12. If an individual returns to Canada after an absence of less than two years, S5-F1-C1 indicates that, in general, he will be considered to have retained Canadian residency during his absence.

True or False?

13. A part year resident for the current year is an individual who either establishes residency in Canada during the current year or, alternatively, terminates residency in Canada during the current year.

True or False?

14. A sojourner is any individual who has been present in Canada for 183 consecutive days in one year.

True or False?

15. In general, if a non-resident individual earns employment income in Canada, he will be subject to Canadian taxation on that income.

True or False?

16. In general, if a non-resident earns income from mining in Canada, it is not subject to taxation in Canada.

True or False?

17. Under the Canada/U.S. tax treaty, if a Canadian resident earns employment income in the U.S. that is \$10,000 or less in U.S. dollars, then the income is taxable only in Canada.

True or False?

18. If a U.S. corporation owns a storage facility in Canada, this will be considered a permanent establishment for purposes of determining which country will tax business income.

True or False?

19. Under ITA 2(3), gains resulting from the disposition of any capital property in Canada by a non-resident will be subject to Canadian income tax.

True or False?

20. A non-resident earning rental income on property in Canada can either pay Part XIII tax or, alternatively, elect to be taxed under Part I.

True or False?

21. All Canadian interest that is earned by non-residents is subject to Part XIII tax.

True or False?

**TIF Problem Twenty - 2**  
*International Income - True Or False*

22. While Canadian dividends paid to U.S. residents are subject to Part XIII tax, the Canada/U.S. tax treaty serves to reduce this rate from the statutory rate of 25 percent.

True or False?

23. When an individual immigrates to Canada, there is a deemed disposition/reacquisition at fair market value of most of their capital property.

True or False?

24. An entity would be a controlled foreign affiliate of a Canadian taxpayer if it is a foreign affiliate of the taxpayer that would, at that time, be controlled by the taxpayer if the taxpayer owned all of the shares of the capital stock of the foreign affiliate that are owned at that time by persons who do not deal at arm's length with the taxpayer.

True or False?

## TIF PROBLEM TWENTY - 3

### International Income - Multiple Choice

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#### New For 2016/2017

##### **Residence Of Individuals**

1. Which of the following is an essential factor in determining whether an individual has ceased to be a resident of Canada?
  - A. The individual has closed his Canadian savings account.
  - B. The individual has given up his membership in the Canuck Country Club.
  - C. The individual has become a resident of another country.
  - D. The individual given up his Ontario driver's licence.

##### **Residence Of Corporations**

2. Which of the following corporations would **NOT** be considered a resident of Canada?
  - A. Dram Inc. was incorporated in Alberta in 2005. While it has operations in both the U.S. and Canada, its management has always been located in New York.
  - B. Craser Ltd. was incorporated in Ontario in 2010. All of its business activities are in Canada and its management is located in Toronto.
  - C. Alor Inc. was incorporated in British Columbia in 2004. While most of its operations are in Canada, management is located in Seattle.
  - D. Exeter Ltd. was incorporated in Alberta in 1956. However, it has never carried on business in Canada and its management has always been located in Montana.

##### **Residence Of Individuals/Corporations**

3. Of the persons described, which one would **NOT** be considered a Canadian resident?
  - A. A person who lives in Leamington, Ontario and commutes to work each day in Detroit, Michigan.
  - B. A corporation that was incorporated in North Dakota, but carries on all of its business in southern Manitoba.
  - C. A member of the Canadian armed forces who has, for the last 3 years, been stationed in Germany.
  - D. A corporation that was incorporated in Winnipeg, but carries on all of its business in North Dakota.

##### **Part I Tax On Non-Residents**

4. Which of the following businesses will be subject to Part I tax in Canada?
  - A. A U.S. company that receives dividends from its Canadian subsidiary.
  - B. A U.S. company that stores its inventory in a Canadian warehouse.
  - C. A multinational manufacturing business that has a factory in Canada.
  - D. A U.S. company that has a temporary office in Canada while searching for a site for its planned Canadian manufacturing plant.

##### **Taxation Of Non-Residents**

5. Darren Brock, a non-resident, borrows \$422,000 and invests it in a Canadian rental property which produces gross annual rental income of \$72,000. The interest costs on the loan total \$6,000, and other expenses of operating the property, including maximum CCA, total \$20,000. Which of the following sets of numbers represents first, the amount that would be taxable to Mr. Brock if he reports his rental income under Part I, and second, if he reports his rental income under Part XIII?
  - A. \$72,000; \$46,000
  - B. \$46,000; \$52,000
  - C. \$72,000; \$66,000
  - D. \$46,000; \$72,000

**Immigration And Emigration**

6. When an individual departs from Canada, there is a deemed disposition of most types of capital property. However, certain items are exempted from this deemed disposition rule. Which of the following items would be among these exemptions?
- A. An extremely valuable coin collection.
  - B. A 72 foot sea-going yacht.
  - C. Shares of a CCPC that primarily provides nursing services.
  - D. Shares of a CCPC that primarily owns rental properties for resale.

**Taxation Of Foreign Source Income**

7. During 2016, Barton Ferris is entitled to \$50,000 in dividends from a publicly listed foreign corporation in which he owns shares. The foreign jurisdiction withholds \$10,000 (20%), providing a net receipt of \$40,000. In addition to the dividend, Martin has Canadian source rental income of \$130,000. He has no tax credits other than his basic personal credit and any credits related to foreign taxes withheld. He has no deductions from Net Income For Tax Purposes in determining Taxable Income. What is the amount of his 2016 Taxable Income?
- A. \$170,000.
  - B. \$177,500.
  - C. \$180,000.
  - D. \$199,000.

**Retained From Previous Editions****Residence Of Individuals**

8. Ms. Froot has been out of Canada for several years. She is presumed to be a non-resident as long as certain tests are met. Indicate the condition that does **NOT** have to be met.
- A. She did not leave a spouse or other dependants in Canada.
  - B. She does not return to Canada on a regular or frequent basis.
  - C. She did not leave personal property or social ties in Canada.
  - D. She did not leave taxable Canadian property in Canada.
  - E. She did establish permanent residence in another jurisdiction.
9. All of the following statements are true, except:
- A. Canadian residents must report their worldwide income for tax purposes.
  - B. If an individual is a resident of Canada for part of the calendar year, that individual only has to report his worldwide income during the period of residency for Canadian tax purposes.
  - C. An individual who immigrates to Canada during the year is a resident of Canada for tax purposes for the full calendar year.
  - D. An individual can be a resident of Canada for tax purposes, even if she is not a Canadian citizen.

10. Of the following individuals, who would be a resident or deemed resident of Canada for tax purposes this year?
- Alex is a U.S. citizen who commutes each day to Canada for employment purposes.
  - Bob is a U.S. citizen who lives in Canada during the week for employment purposes, but returns to the U.S. on weekends to the house he shares with his wife and children.
  - Charles is a Canadian citizen who lived in Toronto until March of last year, at which time he left for a four year aid mission in Africa under an agreement with the Canadian International Development Agency.
  - Dick is a Canadian citizen who goes to school in the U.S. for eight months of each year but returns to Canada to live with his parents each summer.
- A. Alex, Bob and Charles.  
B. Bob, Charles and Dick.  
C. Bob and Charles.  
D. Alex and Dick.
11. With respect to the residency of an individual, which of the following statements is **NOT** correct?
- A. To be a resident for tax purposes, an individual must be a Canadian citizen.  
B. If an individual leaves or enters Canada during the current year, he will be considered a part-year resident for tax purposes.  
C. An individual is a Canadian resident for tax purposes if his principal residential ties are in Canada.  
D. An individual is considered to be a Canadian resident for tax purposes if he visits for more than 183 days in a calendar year.
12. Which of the following factors would **NOT** be relevant under the Canada/U.S. tax treaty tie-breaker rules for determining the residence of an individual?
- A. The country in which the individual earns business income.  
B. The country in which the individual is a citizen.  
C. The country in which the individual has a permanent home available to him.  
D. The country in which the individual has a habitual abode.
13. Jamal, his wife and two teenage children are all Canadian citizens. For the last 2 years he and his family have been living in Mexico while he works for the Mexican subsidiary of a Canadian company. Jamal still owns his house in Canada. His wife and children stay there for 2 months in the summer and he spends 4 weeks a year there. The rest of the time the house is empty as his wife visits family in Canada regularly. Jamal has no definite plans to return to Canada and loves living in Mexico. However, since his mother-in-law is very ill, it is possible that his wife will have to return to Canada for at least 6 months to nurse her mother. Which of the following statements is correct?
- A. Jamal is considered a part-time resident of Canada for the 4 weeks he spends in Canada.  
B. If Jamal's wife returns alone to Canada to care for her mother, Jamal is considered a part-time resident of Canada for the 6 months she is in Canada.  
C. Jamal is considered a non-resident of Canada.  
D. Since Jamal owns a house in Canada that is not rented out under a long-term lease he is considered a Canadian resident for income tax purposes.

14. Of the following individuals, who would be considered a part-year resident of Canada for the current taxation year?
- A. Ravi is a citizen of India, where he was born and lived until moving to Canada on March 1 of the current year with his wife and child. He was transferred by his employer to its Canadian head office.
  - B. Helga had lived and worked in Canada for 10 years. She was transferred by her employer to its flagship hotel in Switzerland on March 1 of the current year for a 1 year training assignment. Her husband remained in Canada to complete his MBA.
  - C. Marc is a French citizen who lives in Paris. On March 1 of the current year he begins work as a translator in Ottawa. It is a 1 year assignment.
  - D. Billy Bob is a U.S. Marshall on loan to the RCMP detachment in Nunavut. It is a 9 month assignment.
15. Dominique, a Canadian citizen, lives in Buffalo, NY, USA. Throughout the current year she commutes to Fort Erie, Ontario, Canada, where she is the bartender at the Cross Border Bar. She normally works 7 pm to 3 am Tuesday through Saturday. Dominique is:
- A. A deemed resident (sojourner)
  - B. A non-resident
  - C. A full-time resident
  - D. A part-year resident
16. Vanessa moves to Germany on July 15 of the current year. She is 35 and has lived in Canada all of her life. Which one of the following best indicates Vanessa's Canadian residency status for the current year?
- A. A deemed resident (sojourner)
  - B. A non-resident
  - C. A full-time resident
  - D. A part-year resident

***Residence Of Individuals/Corporations***

17. In which of the following situations is the person considered a non-resident of Canada, in 2016, for income tax purposes?
- A. James Arder, a recently qualified CPA, based in Montreal, accepted a transfer to an office in Sydney, Australia for the period May 1, 2016 to August 31, 2016. James is not married and had lived at his parent's house in Montreal.
  - B. Karen Cotin, a computer programmer, had been employed by ABC Systems Ltd. in Toronto. In 2015, she accepted a minimum two-year contract with CS Services Inc. in London, England. Her position with CS Services Inc. started October 1, 2015. Before moving to England, where she will join her fiance, Karen terminated the lease on her apartment in Toronto and sold her car.
  - C. N Limited was incorporated in Canada in 1996 and, until May 2015, its manufacturing plant was located in Mississauga, Ontario. In May 2015, it moved all of its operations, including the manufacturing plant, to North Carolina, U.S.A.
  - D. B. Bath, a member of the Canadian Armed Forces, who was stationed in Lahr, Germany from September 1, 2014 to February 1, 2017.

**Part I Tax on Non-Residents**

18. Kenichi Takahawa is a resident of the United States, living in Detroit. He works and earns income in Canada all year as follows:

Employment income in Canada	\$50,000
Business income in Canada	35,000
Interest income on bank account in Canada	3,000
Capital gain from disposition of vacant land in Detroit	7,000

What is his Canadian income under Part I of the Income Tax Act?

- A. \$50,000
  - B. \$85,000
  - C. \$88,000
  - D. \$91,500
19. Fahad Lodhi is a resident of the United States, living in Port Huron, Michigan. He works and earns income in Canada all year as follows:

Employment income in Canada	\$ 9,500
Business income in Canada	30,000
Interest income on bank account in Canada	500
Capital gain from disposition of vacant land in Canada	10,000

What is his income under Part I of the Income Tax Act?

- A. \$30,000
  - B. \$35,000
  - C. \$45,000
  - D. \$44,500
20. Under ITA 115(2) certain non-resident individuals will be deemed to be employed in Canada even when they are not working in Canada. Which of the following non-resident individuals would be deemed to be employed in Canada?
- A. Marcel is employed by a Canadian resident company in a foreign country. The tax treaty with the foreign country subjects his employment income to taxation in that jurisdiction.
  - B. Anita was previously a Canadian resident. She is currently employed by a non-resident company in a foreign country, but receives pension income from a Canadian resident company.
  - C. Johann receives a signing bonus from a non-resident company. His services will be provided in Canada.
  - D. Helen is employed by a Canadian resident company in a foreign country. The tax treaty with the foreign country exempts her employment income from taxation.
21. Merivale is an American corporation with operations throughout the United States. In addition to its U.S. operations, it has a sales office in Calgary. Canadian employees who work out of this sales office take orders for the company's products. The orders are filled from a warehouse in Montana.
- A. Merivale is not subject to Canadian tax because it is not incorporated in Canada.
  - B. Merivale is not subject to Canadian tax because the orders are not filled from a Canadian warehouse.
  - C. Merivale is not subject to Canadian tax because the mind and management of the company is not in Canada.
  - D. Merivale is subject to Canadian tax on the income that is earned by the Calgary office.

22. In which of the following cases, where a U.S. resident disposes of a property, is the gain taxable in Canada?
- A. Joelle Elfassy sells 100 shares in a widely held Canadian public company that has over 10 million shares issued.
  - B. Ku Jung owns a rental property in downtown Vancouver. Ku has owned the property for 3 years and has never lived in it. The property is sold for a substantial gain.
  - C. Danyal Sigindere incorporated a private company in Canada 10 years ago. The company rents space and operates a retail clothing store. Danyal sells the shares for a gain of \$1,000.
  - D. Ariella Incorporated sells its list of Canadian customers to a Canadian business.
23. In the Canada/U.S. tax treaty, the definition of a permanent establishment does not include:
- A. an oil well
  - B. a storage facility
  - C. a factory
  - D. a mine

***Taxation Of Non-Residents***

24. Mike O'Shea, a resident of Ireland, has owned a Canadian rental property for several years. The property is located in Alberta and, during the current year, it was sold for an amount that resulted in a significant capital gain. Which of the following statements is correct with respect to the gain?
- A. Mr. O'Shea is not a Canadian resident and, as a consequence, will not be taxed on this gain.
  - B. Mr. O'Shea will be assessed for a withholding tax under Part XIII of the *Income Tax Act*.
  - C. Mr. O'Shea will be subject to Canadian Part I tax.
  - D. Mr. O'Shea will be subject to Canadian Part I tax as well as Part XIII tax.
25. Many types of income are subject to withholding tax under Part XIII of the *Income Tax Act*. Which of the following would **NOT** be subject to this withholding tax when paid to a non-resident individual? Ignore any tax treaty provisions that might be applicable.
- A. A withdrawal from a RRIF by a former resident of Canada.
  - B. A deferred bonus from a former employer who is resident in Canada.
  - C. Interest on Government of Canada bonds.
  - D. Dividends received from a CCPC.
26. Certain types of Canadian income earned by non-residents are not taxed under Part I of the *Income Tax Act*. Which of the following types of income would be eligible for this treatment? Ignore any tax treaty implications that might be applicable.
- A. Income from the sale of Canadian real estate.
  - B. Interest on a GIC issued by a Canadian bank.
  - C. Income resulting from the exercise of options on the stock of a Canadian public company.
  - D. Recapture resulting from the sale of a Canadian business property.

27. A non-resident individual owns a rental property in Canada. Which of the following statements is correct?
- A. The gross rents are subject to withholding under Part XIII of the *Income Tax Act*. However, the taxpayer can elect to file a Canadian tax return which will include the net rental income.
  - B. The net rental income is subject to withholding under Part XIII of the *Income Tax Act*. However, the taxpayer can elect to file a Canadian tax return which will include the gross rents.
  - C. The taxpayer must file a Canadian tax return which includes the net rental income.
  - D. The net rents are subject to withholding under Part XIII of the *Income Tax Act*.
28. Which type of income is not taxable in the hands of non-residents under either Part I or Part XIII?
- A. Rental income from a property situated in Canada.
  - B. Pension benefits from a Canadian employer.
  - C. Dividend income from a Canadian corporation.
  - D. Interest paid on a savings account at a Canadian bank branch located in Canada.
29. In which of the following cases would the interest payment made to a non-resident be subject to Part XIII withholding tax?
- A. Ling, a resident of a country that does not have a tax treaty with Canada, earns interest of \$5,000 from a Canadian term deposit.
  - B. Jin, a resident of a country that does not have a tax treaty with Canada, earns interest of \$15,000 on a Canadian government bond.
  - C. Dou, a U.S. resident, earns interest of \$42,000 on a loan to Moon Limited, a CCPC. Dou owns 51% of the shares in the company.
  - D. Ying, a resident of a country that does not have a tax treaty with Canada, earns \$25,000 on a loan to Sun Enterprises Limited, a CCPC. Ying owns 40% of the shares in the company.
30. Which of the following types of payment is **NOT** subject to Part XIII Canadian withholding tax when paid to a non-resident?
- A. Dividends
  - B. Pension benefits
  - C. Interest paid to an arm's length party
  - D. Registered retirement savings fund payments

**Immigration And Emigration**

31. Mr. Winsome is a Canadian citizen and has been resident in Canada for the past 35 years. His company has offered him a position with its Australian branch, which Mr. Winsome has accepted. The position is a transfer and Mr. Winsome plans to remain in Australia for the rest of his life. Given the temperate climate in Australia, he thinks it will be a good country to retire in. Mr. Winsome has the following assets in Canada on December 15, 2016, the date of his departure from Canada:

	<u>As At December 15, 2016</u>	
	<u>FMV</u>	<u>ACB</u>
Shares in Bell Canada, a public company	\$10,000	\$ 7,000
Shares in TNX Co., a private company	8,000	5,000
Mutual Funds	10,000	10,000
Sailboat (that he is shipping to Australia)	15,000	18,000

He sold all of his other assets. Which of the following is correct?

- A. Mr. Winsome will be deemed to have disposed of his mutual funds, sailboat, TNX Co. shares and Bell Canada shares on December 15, 2016.
- B. Mr. Winsome can elect to defer the gain on the Bell Canada shares until they are sold, only if security acceptable to the CRA is provided.
- C. Mr. Winsome can elect to have a deemed disposition of the Bell Canada shares on December 15, 2016, only if security acceptable to the CRA is provided.
- D. None of the above.
32. Because of his distaste for Canadian winters, Rob Johnston has emigrated from Canada to Florida. At the time of his departure, his RRSP held assets with a fair market value of \$1,500,000. Which of the following statements is correct?
- A. There will be a deemed disposition of all of these assets at the time of Rob's departure from Canada.
- B. There will be no tax consequences at the time of departure. However, any withdrawals from the plan after his departure will be subject to Canadian Part I tax.
- C. There will be no tax consequences at the time of departure. However, any withdrawals from the plan after his departure will be subject to Canadian Part XIII tax.
- D. Part XIII tax will have to be paid at the time of departure, but there will be no further taxation assessed on withdrawals from the plan.
33. Joan Bias, a U.S. citizen, established Canadian residency in 2012. At the time she entered Canada, she owned shares in a U.S. company that had an adjusted cost base of \$150,000 and a fair market value \$210,000. During 2016, she sold these shares for \$170,000. Which of the following reflects the tax consequence of this sale?
- A. There would be a taxable capital gain of \$20,000.
- B. There would be an allowable capital loss of \$20,000.
- C. There would be a taxable capital gain of \$10,000.
- D. There would be a business investment loss of \$40,000.

**Taxation Of Foreign Source Income**

34. Which of the following conditions must be met in order for a resident Canadian corporation to be able to deduct dividends from a non-resident corporation?
- A. The dividend must be paid out of active business income.
- B. the active business income must be earned in a country with which Canada has a tax treaty or has entered into a tax exchange information agreement.
- C. The non-resident corporation must be a foreign affiliate.
- D. All of the above.

## **TIF PROBLEM TWENTY - 4**

### **International Income - Exam Exercises**

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#### ***Exam Exercise Subject Listing For Chapter 20***

<b>Number</b>	<b>Subject</b>
1	Residential Ties
2	Temporary Absences
3	Temporary Absences
4	Part Year Residence
5	Part Year Residence
6	Individual Residence
7	Individual Residence
8	Corporate Residency
9	Corporate Residency
10	Corporate Residency
11	Carrying On Business In Canada
12	Non-Resident Liability For Tax
13	Non-Resident Employment In Canada
14	Non-Resident Employment In Canada
15	Dispositions Of Taxable Canadian Property
16	Interest Payments To Non-Residents
17	Rental Payments To Non-Residents
18	Emigration
19	Emigration
20	Emigration
21	Short Term Residents
22	Foreign Tax Credits
23	FAPI
24	Dividends From FAPI

**Exam Exercise Twenty - 1 (Residential Ties)**

At the end of the current year, Michael Resner departed from Canada in order to take a permanent position in Mexico. He was accompanied by his common-law partner and their children, as well as what personal property he had not sold. Due to the intent of his neighbour to start a pig farm, he was unable to sell his residence at a satisfactory price. However, he was able to rent it for a period of two years. He also retained his membership in the CPA (Chartered Professional Accountants) Alberta. After his departure, would he still be considered a Canadian resident for tax purposes? Explain your conclusion.

**Exam Exercise Twenty - 2 (Temporary Absences)**

Mary is a Canadian citizen who is employed by a corporation operating in Canada and the U.S. While she has worked for many years in the Canadian office of this organization, she agreed to transfer to the corporation's U.S. head office in New York City. Before leaving, she disposed of her residence and other personal property that she did not wish to move. She canceled her Saskatchewan driver's licence and health care card, and closed all of her Canadian banking and brokerage accounts.

Because her boyfriend remained in Regina, she found herself flying back to Canada at least once a month. After two years, she concluded that between the high cost of living in New York City and the travel required to maintain the relationship with her boyfriend, she would return to Canada. Would Mary be considered a Canadian resident during the two years that she was absent from Canada? Explain your conclusion.

**Exam Exercise Twenty - 3 (Temporary Absences)**

John Acheever is employed by Research In Limbo. He has worked for a number of years in their office in Kitchener, Ontario. However, he has become convinced that he would have quicker advancement if he transferred to their office in New York City. He requests this transfer and moves to that location in September, 2016. Before leaving he cancels his apartment lease, sells all of the personal property that he does not wish to move, and cancels his Ontario driver's licence. However, he retains his Canadian banking and brokerage accounts and, because of concerns about the cost of U.S. health care, he does not cancel his Ontario health care card (he changes the address to that of his parents in Waterloo, Ontario). He has also left his dog, Bart with his parents.

After the move, he is shocked to realize how much he misses Bart. He finds himself flying back to Kitchener at least twice a month to spend the weekend caring for Bart. By February, 2018, after not being able to find a suitable dog-friendly apartment in New York City, John returns to his position in Kitchener. He has no plans to return to the U.S. Would John be considered a Canadian resident during the 18 months that he was absent from Canada? Explain your conclusion.

**Exam Exercise Twenty - 4 (Part Year Residence)**

Melissa is a Canadian citizen who has been employed in Vancouver for the last five years. She has accepted a new position in the United States and, as of March 15 of the current year, flies to New Mexico to assume her responsibilities. She has been granted a green card to enable her to work in the U.S. Her husband remains behind with the children until July 1, after the end of their school year. On that date, they fly to New Mexico to join Melissa. Their residence is sold on August 1 of the current year, at which time a moving company picks up their furniture and other personal possessions. The moving company delivers these possessions to their new house in New Mexico on August 15. Explain how Melissa will be taxed in Canada during the current year.

***Exam Exercise Twenty - 5 (Part Year Residence)***

Barton Vader is a Canadian citizen who has always lived in London, Ontario. He has a spouse and two school-aged children. As of May 2016, he accepts a new employment position in Akron, Ohio. On October 1, 2016, he moves to Akron to locate housing for his family. In order for his children to finish the school term, his family remains in London until January 1, 2017. When they move, John severs all residential ties with Canada other than the family residence. The residence is placed on the market in January, 2017. However, it has not been sold as of December 31, 2017.

While Barton was scheduled to begin working in the U.S. in early 2017, he is unable to obtain the required residency documents until July 1, 2017.

Explain Barton's Canadian tax status for the years 2016 and 2017.

***Exam Exercise Twenty - 6 (Individual Residency)***

Mary Sothor is the Canadian ambassador to Tanzania. She was a resident of Canada immediately prior to her appointment as ambassador. Living with her in Tanzania's capital city are her husband and two children. Her husband was born in Canada and was a Canadian resident at the time of their marriage. He is exempt from Tanzanian taxation because he is the spouse of a foreign diplomat. Her 25 year old son was born in Canada and works for a Tanzanian company. His income exceeds \$30,000 annually. Her 16 year old son was born in Kenya and is a full time student with no income of his own. Which of these individuals would be considered Canadian residents for tax purposes? Explain your conclusions.

***Exam Exercise Twenty - 7 (Individual Residency)***

Ms. Sharon Washton was born 26 years ago in Bahn, Germany. She is the daughter of a Canadian High Commissioner serving in that country. Her father still holds this position. However, Ms. Washton is now working in Prague, Czechoslovakia. The only income that she earns in the year is from her Prague marketing job and is subject to taxes in Czechoslovakia. She has never visited Canada. Determine the residency status of Sharon Washton.

***Exam Exercise Twenty - 8 (Corporate Residency)***

Nixon Inc. was incorporated as an Ontario corporation in 2008. However, since 2012, all of the Company's business has been carried on outside of Canada. Determine the residency status of Nixon Inc.

***Exam Exercise Twenty - 9 (Corporate Residency)***

Wolfhowl Ltd. was incorporated in Banff, Alberta in 1961. Despite its Canadian charter, the Company has never carried on business in Canada. However, until 1971, all meetings of the Board of Directors were held in Banff. Since 1971, all board of directors meetings have been held in Wyoming. Determine the residency status of Wolfhowl Ltd.

***Exam Exercise Twenty - 10 (Corporate Residency)***

Acton Enterprises was incorporated in Montana in 1964. Until 2012, all of the company's directors were residents of Bozeman, Montana, with all meetings held in that city. However, in 2012, all of the directors moved to Calgary, Alberta, with all subsequent meetings held in that city. Determine the residency status of Acton Enterprises for the taxation year ending December 31, 2016.

**Exam Exercise Twenty - 11 (Carrying On Business In Canada)**

In each of the following Cases, determine whether Rawlings Inc., a non-resident U.S. corporation, is taxable in Canada:

**Case 1** Rawlings is the parent company of Delma Ltd., a company incorporated in British Columbia. Rawlings produces and sells small construction equipment, while Delma produces and sells hand tools. Rawlings sells pieces of equipment to Delma, who in turn sells them in Canada.

**Case 2** Rawlings manufactures small construction equipment in the U.S. Rawlings ships pieces of equipment to a warehouse located in Winnipeg that is rented on a seven year lease. Rawlings has employed an individual in Winnipeg to sell the equipment throughout central Canada. The employee is not allowed to conclude contracts without approval by the U.S. office.

**Case 3** Assume the same facts as in Case 2, except that the employee has the authority to conclude contracts on behalf of the employer.

**Exam Exercise Twenty - 12 (Non-Resident Liability For Tax)**

Ms. Michelle Walker, a U.S. citizen, has Canadian employment income of \$22,000 and U.S. employment income of \$40,000 Canadian for the current year. The Canadian employment income is from a British Columbia company that can deduct the payments in its Canadian tax return. She lives in Seattle, Washington and is a resident of the United States for the entire year. Ms. Walker does not believe that she is subject to taxation in Canada. Is she correct? Explain your conclusion.

**Exam Exercise Twenty - 13 (Non-Resident Employment In Canada)**

In each of the following Cases, determine whether the employment income is taxable in Canada:

**Case 1** Mary resides in the state of Maine. She accepted temporary employment as a personal trainer with a Canadian company for clients in New Brunswick beginning August 1, 2016 and ending on December 31, 2016. The Canadian employer agreed to pay her \$2,660 Canadian per month. Mary remained a non-resident of Canada throughout her Canadian employment.

**Case 2** Assume the same facts as in Case 1, except the employer was resident in Maine and did not have a permanent establishment in Canada.

**Case 3** Bill resides in Watertown, New York and has commuted daily to a full-time job in Kingston, Ontario for the last five years. In 2016, he spent 217 days at his job in Canada. He works for the municipality of Kingston and earned \$53,000 Canadian in employment income. Bill is a U.S. resident throughout the year.

**Exam Exercise Twenty - 14 (Non-Resident Employment In Canada)**

In each of the following Cases, determine whether the employment income is taxable in Canada:

**Case 1** John lives in Blaine, Washington and is a U.S. citizen. However, he is employed by a business in Chilliwack, British Columbia. His salary for 2016 is \$72,000. As he is able to do some of his work in his home office in Blaine, he commutes to Chilliwack for 150 days during 2016.

**Case 2** Martin is a U.S. citizen who lives in Vermont. He is employed by a U.S. business that does not have a permanent establishment in Canada. During the period March 1, 2016 through June 30, 2016, Martin is required to work in Montreal. His \$5,000 per month salary is paid by his U.S. employer.

**Case 3** Assume the same facts as in Case 2 except that his U.S. employer has a subsidiary in Montreal. During the period that he is working in Montreal, his salary is paid by the Montreal subsidiary.

**Exam Exercise Twenty - 15 (Dispositions Of Taxable Canadian Property)**

In each of the following Cases, determine whether the U.S. resident who is disposing of property is taxable under Part I in Canada on any gain resulting from the disposition.

**Case 1** In 2011, Anne Mason acquired a condo in Canmore, Alberta that she rented to Canadian residents. She sold the condo in 2016 at a considerable gain. Anne never occupied the condo.

**Case 2** Assume the same facts as in Case 1, except that Anne incorporates a private corporation under Alberta legislation which acquires the condo. Anne sells the shares of the private company at a later point for a considerable gain.

**Case 3** Assume the same facts as in Case 2, except the corporation is created under Oregon state legislation.

**Exam Exercise Twenty - 16 (Interest Payments To Non-Residents)**

In each of the following Cases, determine whether the interest payments made to non-residents are subject to Part XIII withholding tax.

**Case 1** Phillip, a resident of Montana, earned interest of \$2,250 on Canada Savings Bonds in 2016.

**Case 2** Marsha, a resident of Halifax, acquired a vacation property in California for personal purposes. The property is mortgaged with a U.S. bank. Marsha paid \$16,500 in interest to the U.S. bank in 2016.

**Case 3** Assume the same facts as in Case 2, except that Marsha had acquired the California condo in 2010 for cash. In 2016, she mortgages the property with a U.S. bank and uses the money to support a business she carries on in Halifax.

**Exam Exercise Twenty - 17 (Rental Payments To Non-Residents)**

In each of the following Cases, determine how the rental payments made to non-residents will be taxed by Canada.

**Case 1** Carco is a U.S. corporation with worldwide rental facilities dedicated to automobile rentals. Carco has offices in New Brunswick, where it rents out small and medium sized vehicles.

**Case 2** In 2013, Danielle Clark, a U.S. resident, acquired several cottages in Manitoba that she rents out. In 2016, she rented the cottages to Canadian residents exclusively. Danielle received \$46,000 in gross rents and estimates that expenses, including CCA, totaled \$17,500.

**Case 3** Assume the same facts as in Case 2, with one additional consideration. Danielle acquired four all terrain vehicles in 2014, which she rented to guests of the cottages for an additional cost. In 2016, she received \$4,000 in gross rents and estimates all terrain vehicle related expenses of \$2,500.

**Exam Exercise Twenty - 18 (Emigration)**

Mr. Ryan Marchand owns publicly traded securities with an adjusted cost base of \$30,000 and a fair market value of \$56,000. During the current year, he permanently departs from Canada still owning the shares. What would be the tax consequences of his departure, if any, with respect to these securities?

**Exam Exercise Twenty - 19 (Emigration)**

Mrs. Lorna Rand owns a rental property in Calgary, Alberta with a cost of \$175,000 and a fair market value of \$315,000. The land values included in these figures are \$52,000 and \$70,000, respectively. The UCC of the building is \$91,400. During the current year, Mrs. Rand permanently departs from Canada. What are the current and possible future tax consequences of her departure with respect to this rental property?

**Exam Exercise Twenty - 20 (Emigration)**

Mr. Jordan Koch owns shares in a Canadian private company with an adjusted cost base of \$115,000 and a fair market value of \$240,000. In addition, he owns a rental property with a fair market value of \$105,000 (\$27,000 of this can be attributed to the land) and a cost of \$200,000 (\$55,000 of this can be attributed to the land). The UCC of the building is \$121,000. During the current year, Mr. Koch permanently departs from Canada.

Calculate the minimum and maximum Net Income For Tax Purposes that could result from his departure.

**Exam Exercise Twenty - 21 (Short Term Residents)**

For many years, Dakota Fox was a resident of Israel. However, in 2015, she concludes that she would like to move to an area with a cooler climate and accepts an employment position in Canada. At this time, her capital assets consist of a tract of Canadian land which she purchased on a previous visit to research living in Canada, and shares in an Israeli utility company. The land has an adjusted cost base of \$125,000 and a fair market value of \$200,000. The shares have an adjusted cost base of \$85,000 and a fair market value of \$115,000.

While she is in Canada, she acquires shares of a Canadian company, Grizzly Bare Inc. for \$55,000. In 2017, after finding Canadian winters to be too severe, she decides to move back to Israel. At this time the values of her assets are as follows:

Canadian Land	\$250,000
Israeli Company Shares	135,000
Grizzly Bare Inc. Shares	70,000

What are the tax consequences of Dakota's emigration from Canada?

**Exam Exercise Twenty - 22 (Foreign Tax Credits)**

Shelley Burns is a Canadian resident living in Sudbury, Ontario. In 2016, she earns \$23,000 of business income from a foreign country with which Canada does not have a tax treaty. Shelley has no permanent establishment in the foreign country. Income taxes of \$2,300 were assessed and withheld at the source on that income. All amounts are in Canadian dollars. Assume that her marginal combined federal/provincial tax rate is 42 percent and that the foreign tax credit is equal to the tax withheld. Determine her after tax retention and overall tax rate on her foreign source business income.

**Exam Exercise Twenty - 23 (FAPI)**

Subco is a 100 percent owned foreign subsidiary of Parco, a resident Canadian company. During 2016, Subco earns \$250,000 of investment income and pays 15 percent tax on this income in the foreign jurisdiction. None of the after tax income is paid out as dividends. What is the effect of this information on Parco's 2016 Net Income For Tax Purposes?

**Exam Exercise Twenty - 24 (Dividends From FAPI - Twenty-23 Continued)**

Subco is a 100 percent owned foreign subsidiary of Parco, a resident Canadian company. During 2016, Subco earns \$250,000 of investment income and pays foreign taxes of 15 percent tax on this income. In 2017, Subco distributes its net after-tax FAPI of \$212,500  $[(\$250,000)(1 - 15\%)]$  to Parco as a dividend. There are no withholding taxes on the dividend payment. What is the effect of this information on Parco's 2017 Net Income For Tax Purposes?

## **TIF PROBLEM TWENTY - 5A**

### **International Income - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

**Chapter Coverage** Terms A to F and definitions 1 to 8, plus 11 can still be used if Part II of Chapter 20 has not been covered.

The following eight key terms are listed at the end of Chapter 20, “International Issues In Taxation”.

- A. Deemed Resident
- B. Dual Resident
- C. Sojourner
- D. Tie-Breaker Rules
- E. Part Year Resident
- F. Resident
- G. Foreign Accrual Property Income
- H. Foreign Affiliate

The following list contains ten potential definitions for the preceding key terms.

1. A person who is located in a place.
2. An individual who either enters Canada during the year and becomes a resident or, alternatively, an individual who departs from Canada during the year and gives up their resident status.
3. Provisions in international tax treaties that are designed to prevent the double taxation of dual residents.
4. An individual who is considered a resident of Canada because of some factor other than physical presence in Canada.
5. A bilateral agreement between two countries which establishes rules for dealing with cross-jurisdictional tax issues.
6. An individual who is deemed under ITA 250 to be a Canadian resident for the full taxation year as the result of having been temporarily present in Canada for 183 days or more.
7. A taxpayer who is considered to be a resident of two countries.
8. A corporation, trust, or any other type of entity that exists, was formed or organized, or was last continued under the laws of a country other than Canada.
9. A non-resident corporation in which a Canadian taxpayer has an equity percentage of at least 1 percent and the aggregate equity percentages of the taxpayer and any related parties must be at least 10 percent.
10. Income of a controlled foreign affiliate from property, income from inactive businesses, taxable capital gains from properties not used in an active business, and income from an investment business.

**TIF Problem Twenty - 5A**  
*International Income - Key Term Matching (Easy)*

11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM TWENTY - 5B**

### **International Income - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

**Chapter Coverage** Terms A to F and definitions 1 to 10, plus 15 can still be used if Part II of Chapter 20 has not been covered.

The following eight key terms are listed at the end of Chapter 20, “International Issues In Taxation”.

- A. Deemed Resident
- B. Dual Resident
- C. Sojourner
- D. Tie-Breaker Rules
- E. Part Year Resident
- F. Resident
- G. Foreign Accrual Property Income
- H. Foreign Affiliate

The following list contains 14 potential definitions for the preceding key terms.

1. A person who is located in a place.
2. An individual who either enters Canada during the year and becomes a resident or, alternatively, an individual who departs from Canada during the year and gives up their resident status.
3. Provisions in international tax treaties that are designed to prevent the double taxation of dual residents.
4. An individual who is considered a resident of Canada because of some factor other than physical presence in Canada.
5. A bilateral agreement between two countries which establishes rules for dealing with cross-jurisdictional tax issues.
6. An individual who is deemed under ITA 250 to be a Canadian resident for the full taxation year as the result of having been temporarily present in Canada for 183 days or more.
7. A person who either enters Canada during the year and becomes a resident or, alternatively, a person who departs from Canada during the year and gives up their resident status.
8. An individual, corporation, or trust that is considered to be a resident of Canada because of some factor other than physical presence in Canada.
9. A taxpayer who is considered to be a resident of two countries.
10. A corporation, trust, or any other type of entity that exists, was formed or organized, or was last continued under the laws of a country other than Canada.

*International Income - Key Term Matching (Moderate)*

11. A non-resident corporation in which a Canadian taxpayer has an equity percentage of at least 1 percent and the aggregate equity percentages of the taxpayer and any related parties must be at least 10 percent.
12. Income of a controlled foreign affiliate from property, income from inactive businesses, taxable capital gains from properties not used in an active business, and income from an investment business.
13. A non-resident corporation in which a Canadian corporation has an equity percentage of at least 1 percent and the aggregate equity percentages of the investor and any related parties must be at least 10 percent.
14. Income of a foreign investment entity from property, income from inactive businesses, taxable capital gains from properties not used in an active business, and income from an investment business.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM TWENTY - 6****Residency After Departure From Canada**

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Mr. Desmond Morris has spent his entire working life with his current employer, the Alcorn Manufacturing Company. In his first years with the Company, he was located in Winnipeg, Manitoba as a production supervisor. More recently, he was transferred to the Company's Calgary based subsidiary, where he has served as a manufacturing vice president until the current year.

Early in the current year, Mr. Morris was asked to move to the United States by April 1 to oversee the construction of a new manufacturing operation in Sarasota, Florida. It is expected that when the facility is completed, Mr. Morris will remain as the senior vice president in charge of all of the Florida operations. He does not have any intention of returning to live in Canada during the foreseeable future.

On April 1, Mr. Morris left Canada. In preparation for his departure, he had taken care to sell his residence, dispose of most of his personal property, and resign from all memberships in social and professional clubs. However, because Mr. Morris and his wife had three school age dependent children, it was decided that they would remain in Canada until the end of the current school year. As a consequence, Mrs. Morris and the children did not leave Canada until June 30. Until their departure, they resided in a small furnished apartment, rented on a month to month basis.

**Required** For purposes of assessing Canadian income taxes, determine when Mr. Morris ceased to be a Canadian resident and the portion of his annual income which would be assessed for Canadian taxes. Explain your conclusions.

**TIF PROBLEM TWENTY - 7****Residency Of Individuals And Taxation Of Non-Residents**

The following independent Cases describe situations in which income has been earned by an individual. In each of the Cases, indicate whether the income amounts described would be subject to Canadian taxation. Explain the basis for your conclusions.

**Case A** Donald Plessner is a U.K. citizen who immigrated to Canada on July 1 of the current year. He immediately began employment as a retail clerk and, during the period July 1 through December 31, his employment income totaled \$11,000. In addition, he has retained a large savings account in the U.K. Interest on this account, which was earned uniformly over the current year, totaled £11,000.

**Case B** Uta Jurgens is the spouse of Colin Jurgens, a member of the Canadian armed forces stationed in Germany. Mrs. Jurgens is a German citizen and has never visited Canada. During the current year, she has employment income of €28,000. She is exempt from German taxation because she is the spouse of a member of the Canadian armed forces.

**Case C** Martin Downs is a U.S. citizen who lives in Detroit, Michigan. He is employed two days each week in Windsor, Ontario by a local landscaping business. During the current year, he is paid \$15,000 (Canadian) for this work. In addition, he maintains a savings account at a bank in Windsor. This account earned interest of \$1,500 during the current year.

**Case D** Sarah Mennan is a Canadian citizen who lives in Syracuse, New York. She works as an accountant in that city, and has professional income of \$72,000. Ten years ago, she left her husband at the end of the second period of the final game of the Stanley Cup Playoffs. She departed from Canada the following day, and has vowed to never set foot in Canada again. She is divorced from her husband and has no assets in Canada, other than a small savings account on which she earned interest of \$150 during the current year.

## **TIF PROBLEM TWENTY - 8**

### **Residency Of Corporations**

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Indicate which of the corporations described in the following Cases would be considered residents of Canada for the current year. Explain the basis for your conclusion.

**Case A** Bonix Ltd. was incorporated in Canada in 1981. While it operated in Canada for a number of years, all of its operations, management and directors relocated to the United States in 2008.

**Case B** Dorad Inc. was incorporated in Ohio in 2003. For several years, all of its directors were residents of Canada, with board meetings being held in Windsor, Ontario. However, in 2008, all of the directors moved to Toledo, Ohio. All Board Of Directors meetings are now held in that city.

**Case C** Upton Inc. was incorporated in Delaware in 2008. However, the head office of the corporation is in Halifax, Nova Scotia. All of the directors of the corporation are Canadian residents and all meetings of the board of directors are held in Halifax.

**Case D** Carlin Inc. was incorporated in Canada in 2005. However, its directors have always been residents of the United States, with all of the company's Board Of Directors meetings held in that country.

## **TIF PROBLEM TWENTY - 9**

### **Residency Of Individuals And Corporations**

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For each of the following persons, indicate how they would be taxed in Canada for the current year. Your answer should explain whether the person is a Canadian resident, what parts of their income would be subject to Canadian taxation, and the basis for your conclusions.

- A. Mr. Samuel Salazar lives in Detroit, Michigan and is a full time employee of a business in Windsor, Ontario. His responsibilities with the business in Windsor require him to be present for about eight hours per day, five days per week. His annual salary in his Windsor position is \$72,000 per year.
- B. Mr. John Wills is a Canadian citizen who, until September 1 of the current year, had spent his entire life living in Regina. On September 1 of the current year, after disposing of all of his Canadian property, Mr. Wills moved his entire family to Bismarck, North Dakota where he opened a mixed martial arts school.
- C. Joan Brothers was born in Livonia, Michigan. She is seven years old and has never visited Canada. She has no income of her own. Her father has been consul in the Canadian Consulate in Livonia for the past 15 years. He was a resident of Canada immediately prior to his appointment as consul.
- D. Brogan Inc. was incorporated in Montana in 1989, but until five years ago, all of the directors' meetings were held in Calgary, Alberta. Five years ago, the president of the Company moved to Butte, Montana and since that time all of the directors meetings have been held in Butte.
- E. Mercer Ltd. was incorporated in British Columbia in 1963 and all of its directors' meetings were held in Vancouver until May, 1993. In June, 1993, all of the directors moved to Portland, Oregon and all subsequent directors' meetings were held in Portland.
- F. The Booker Manufacturing Company was incorporated in 1963 in Minnesota. The directors of the Company have always been residents of Winnipeg and, as a consequence, all meetings of the Board of Directors have been held in Winnipeg since the Company was first incorporated.

## **TIF PROBLEM TWENTY - 10**

### **Residency Of Individuals And Corporations**

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Pertinent facts are given for a different individual or corporation in each of the Parts of this problem. For each Part, indicate whether or not this individual or corporation would be considered a Canadian resident for income tax purposes during the current year. Briefly explain your conclusion.

**Part A** Dorothy is married to Jack, who is a member of the Canadian armed forces serving in Indonesia. Other than a brief visit to Jack's parents' home in Halifax, she has never been to Canada in her life. Because Jack is a member of the Canadian armed forces, neither he nor his wife is subject to taxation in Indonesia.

**Part B** Alice is a U.S. citizen living in Seattle, Washington. While she leaves many of her belongings at her parent's home in that city, she spends at least four days every week living with her boyfriend in Burnaby, British Columbia. They plan to be married at some future date.

**Part C** Last year, John transferred to the Cayman Islands office at the request of his Canadian employer. His three year employment contract calls for him to return to work in Canada after its completion. On his departure from Canada, he severed all residential ties with Canada.

**Part D** Millicent is a U.S. citizen who, until last year, had lived and worked in Canada as a landed immigrant for over 20 years. Last year, after winning \$2 million in an Ontario lottery, she left Canada on a two year pleasure trip that will take her to virtually every country in the world. Her husband and children, all Canadian citizens, continue to live at the family home in Port Hope, Ontario.

**Part E** Berkly Management Inc. was incorporated in Alberta in 1963. Until 1986, its only director resided in that province. In that year, the director was replaced by an individual resident in Fresno, California.

**Part F** Lorris Ltd. was incorporated in Wisconsin in 1983. Until 1992, all of the directors of the corporation lived in Kenora, Ontario. During this period, the Board of Directors meetings were held in that city. Beginning in 1992, all of the directors have been residents of Green Bay, Wisconsin and all of the Board of Directors meetings have been held in Green Bay.

## **TIF PROBLEM TWENTY - 11**

### **Part I Tax On Non-Residents**

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The following material describes several independent cases which involve U.S. citizens or companies that have some type of Canadian source income.

**Case A** Sharon Broley is a U.S. citizen who maintains a home in the U.S. However, during the current year she accepts an employment contract which 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 responsible for paying both the salary and the allowance.

**Case B** Mariah Capri is a U.S. citizen and a resident of the U.S. She is asked by her U.S. employer to spend 2 months working in Toronto. Her employment income during this period is \$18,000, all of which is paid by her U.S. employer.

**Case C** Shae Kira is a U.S. citizen and a resident of the U.S. A number of years ago she established a Canadian private corporation in order to acquire rental properties in Canada's major metropolitan areas. She has been the sole shareholder of that corporation. During the current year, she sells these shares resulting in a gain of \$562,000.

**Case D** Rae Downer is a U.S. citizen and a resident of the U.S. 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 Canadian income tax.

## **TIF PROBLEM TWENTY - 12**

### **Part XIII Tax On Non-Residents**

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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 1** Bryan is a resident of the United States. He 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, he receives interest of \$1,422.

**Case 2** Michael is a resident of a country that does not have a tax treaty with Canada. During the current year he earns \$565 of interest on a savings account in the Bank of Nova Scotia.

**Case 3** Brigitte is a resident of a country that does not have a tax treaty with Canada. During the current year, Brigitte receives \$4,800 in dividends from a Canadian private company. Brigitte owns 30 percent of this company's voting shares.

**Case 4** Richard is a resident of the United States. He owns construction machinery which is located in Canada. The machinery is leased throughout the current year to Canadian residents. His gross rents are \$546,000 and the related expenses, including maximum CCA, are \$327,000. Richard does not have a permanent establishment in Canada.

**Case 5** Frank is a resident of a country that does not have a tax treaty with Canada. He is the owner of a real property in Edmonton that he rents to Canadian residents. His gross rents for the current year are \$23,000. Expenses related to the property, including maximum CCA, are \$13,000.

**Case 6** Kristopher 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 \$347 from this investment.

**Required:** For each of these situations, indicate how the Canadian source income would be taxed under Canadian tax legislation.

**TIF PROBLEM TWENTY - 13****Emigration - Part Year Resident, Net Income For Tax Purposes**

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Ms. Norah Houston is employed by a large, publicly-traded Canadian company. She is a Canadian citizen and, for all of her life, she has been living and working in Canada. She does not have a spouse, common-law partner, or dependants. During 2016, her employer asks her if she would be willing to transfer to their Australian operation. As she believes that she will have more challenging work in that location, she agrees to the move. Both Ms. Houston and the company expect this move to be permanent.

On July 31, 2016 she closes all of her Canadian bank accounts. This includes a savings account on which she has received interest of \$3,500 during 2016 prior to her departure.

On August 1, 2016, she opens bank accounts in Sydney. Interest on her Australian savings account during the rest of 2016 was earned at a rate of \$500 per month. (All amounts given in this problem are in Canadian dollars.)

On August 1, 2016 she departs from Canada. However, because she has taken no time off in several years, she spends the month of August visiting various cities in southeast Asia. She arrives in Australia and establishes residence in Sydney on September 1, 2016.

Ms. Houston's annual salary for 2016 is \$144,000, with monthly payments of \$12,000. Because she had accumulated vacation credits, her payments were not altered by the time she spent traveling in August.

Ms. Houston lived in a rented condominium and was able to cancel the lease prior to her departure on August 1, 2016. No cancellation payment was required.

At the beginning of 2016, Ms. Houston owned shares in three Canadian public companies. All of these shares were sold prior to her departure, resulting in the following capital gains and losses:

- The sale of Cando Ltd. resulted in a capital gain of \$27,300.
- The sale of Darcy Inc. resulted in a capital loss of \$14,500.
- The sale of Marganto Ltd. resulted in a capital loss of \$6,800.

Prior to her departure, Ms. Houston was operating a mail order business out of her condominium. On July 31, 2016, she closes down this business. For the period January 1 through July 31, 2016, the business had a loss of \$27,000.

During 2016, Ms. Houston made support payments to her former spouse of \$2,000 on the first day of each month until his death in a mysterious boating accident on August 28, 2016. She made a deductible contribution to her Canadian RRSP in the amount of \$8,800 on May 1, 2016. The RRSP was not collapsed on Ms. Houston's departure from Canada.

**Required:**

- A. Determine Ms. Houston's residency status for 2016 and explain your conclusion.
- B. Calculate Ms. Houston's Net Income For Tax Purposes that will be included in her 2016 Canadian tax return and any loss carry overs that will be available to her at the end of 2016. Ignore any possible implications related to the Canada/Australia tax treaty.

## **TIF PROBLEM TWENTY - 14**

### **Residency After Departure From Canada**

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Mr. Howard Rankin has decided to permanently depart from Canada at the end of 2016. To this end, he severs all of his residential ties with Canada and establishes residency in the United States as of January 1, 2017.

On December 31, 2016, Mr. Rankin owns the following assets:

	<b>Fair Market Value</b>	<b>Capital Cost Or Adjusted Cost Base</b>
City Home	\$650,000	\$325,000
Cottage (Personal Use Only)	180,000	45,000
Automobile (Personal Use Only)	22,000	48,000
Cash	180,000	N/A
RRSP	220,000	Nil
Shares In A CCPC (That Provides Cleaning Services)	80,000	65,000
Shares In Banks (Public Companies)	120,000	42,000

**Required:** For each of these assets, indicate to Mr. Rankin the tax consequences that will result from his departure from Canada, assuming that he does not make any elective dispositions. Explain your conclusions.

## **TIF PROBLEM TWENTY - 15**

### **Foreign Investment Reporting Rules**

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The following assets are owned by different Canadian taxpayers who hold no other foreign investments at any time during the year. All amounts are in Canadian dollars. For each asset, determine whether the foreign investment reporting rules apply. Explain your conclusions.

1. A cottage in Vermont that was purchased several years ago for \$185,000 and is used exclusively by the Canadian taxpayer. It is estimated that its current fair market value is \$320,000.
2. A savings account in a California bank that has a balance that fluctuates from \$21,000 to \$315,000 and an end of the year balance of \$86,000.
3. Shares in a U.S. public company. The shares have a cost of \$75,000. They have a current market value of \$270,000.
4. A manufacturing plant located in New Jersey. It has a capital cost of \$2,500,000. It is in active use to produce plastic auto parts.

## **TIF PROBLEM TWENTY - 16**

### **Foreign Source Investment Income**

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Amy Borody works and resides in Winnipeg, Manitoba. During 2016, Ms. Borody has diversified her investment portfolio by investing in German company stocks through her Canadian registered securities dealer. The cost of her German company stocks total €50,000. Ms. Borody owns a rental property in Munich, Germany which cost €400,000 in 2015. She has a bank account in a German bank. Its balance fluctuates from €500 to €25,000 during 2016. Its year end balance is €10,000.

During 2016, she earned the following amounts of investment income:

Dividends From German Public Corporations (Amount Received)	€ 5,100
Interest On Bank Account	€ 2,000
Gross Rental Income From Munich Apartment	€30,000
Net Rental Income From Munich Apartment	€18,000

The dividends are net of German withholding taxes of 15 percent. Ms. Borody has left the interest in her German bank account and has not transferred it to Canada.

Ms. Borody uses the election to have her net rental income taxed in Canada under Part I, rather than under Part XIII. As she does not take CCA on the rental property, all of the rents and related expenses can be translated using the 2016 exchange rate.

Assume that the exchange rate throughout 2016 was €1 = \$1.45.

**Required:** Indicate the amounts of investment income that would be included in Ms. Borody's 2016 Net Income For Tax Purposes, as well as any tax credits that would be available to Ms. Borody to offset this income.

**TIF PROBLEM TWENTY - 17****Foreign Source Dividends Received By An Individual**

Mark Lender lives and is employed on a full time basis in Canada. His net employment income for 2016 is \$67,500. In addition he has the following other sources of income during the year:

Taxable Capital Gains	\$ 4,500
Eligible Dividends From A Canadian Company	12,000
Dividends From Foreign Companies Before Foreign Tax Withheld:	
Foreign Country 1 - SP Ltd. (Before \$4,250 Of Withholding)	\$17,000
Foreign Country 2 - FR Ltd. (Before \$800 Of Withholding)	8,000

He has the following deductions available in determining his 2016 Taxable Income:

Net Capital Loss Carry Forward	\$8,000
Business Loss Carry Forward	\$6,200

His only tax credits are the basic personal credit, employment related credits, and any credits related to the dividends received.

**Required:** Determine Mark's Federal Tax Payable for the year ending December 31, 2016.

## **Chapter Twenty-One Test Item File Problems**

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### **TIF PROBLEM TWENTY-ONE - 1** **GST/HST - Essay Questions**

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1. Briefly describe the advantages, from the point of view of business organizations, of an HST system as compared to a combined GST/PST system.
2. Describe two factors that have been influential in the increased use of transaction taxes in various countries around the world.
3. What is the basic problem with a multi-stage tax that is assessed on turnover at the various stages of the production/sale cycle?
4. Explain the difference between an accounts-based value added tax and invoice-credit value added tax.
5. Describe the GST/HST consequences related to the sale of:
  - fully taxable goods and services;
  - zero-rated goods and services; and
  - exempt goods and services.
6. Describe the "place of supply" rules as they apply to (1) tangible goods other than real property, and (2) services.
7. John is a resident of Ontario where a 13 percent HST rate is in effect. He is acquiring a new car from a car dealer and is being given a trade-in allowance for his old vehicle. Explain how the HST will apply to John's purchase.
8. Give two examples of entities that would have to file a GST or HST return, but do not have to file an income tax return.
9. Explain how the GST/HST registration requirements apply to non-residents.
10. Describe the "last four calendar quarters" test that is used to determine eligibility for the small suppliers exemption.
11. A person with taxable sales of less than \$30,000 in the previous calendar year has asked your advice as to whether he should register for GST/HST purposes. What questions should you ask him about his business in order to give the appropriate advice?
12. How are input tax credits calculated when registrants purchase capital expenditures that are (1) real property and (2) furniture and fixtures?
13. How are input tax credits calculated on the current expenditures of a business?
14. Provide two examples of expenditures where available input tax credits are restricted, even when the expenditures involved commercial activity.
15. GST amounts are included in revenues, expenses, assets, and liabilities of most business enterprises. How should these amounts be dealt with in the financial statements of these enterprises?

16. Certain qualifying registrants can use the Quick Method of accounting for GST/HST. What are the advantages of using this method?
17. Briefly describe the streamlined method of accounting for input tax credits.
18. Under what circumstances would an entity choose to file a GST or HST return more frequently than required by the *Excise Tax Act*?
19. Indicate two situations where the fact that two companies are associated would influence GST/HST procedures.
20. What is the objective of the employee/partner GST/HST rebate?
21. Briefly describe the GST/HST rebate that is available on purchases of new residential housing in those provinces that do not participate in the HST program.
22. The disposal of a complete business through a sale of its assets is a taxable supply for GST/HST purposes. However, there is an election that allows the vendor and purchaser to treat the supply as if it were zero-rated. What conditions must be present for this election to be used?

## **TIF PROBLEM TWENTY-ONE - 2**

### **GST/HST - True Or False**

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#### **New For 2016/2017**

1. Those provinces that participate in the Harmonized Sales Tax program do not have a provincial sales tax.

True or False?

2. An advantage of transaction taxes is they keep tax revenues in the country in which they are assessed.

True or False?

3. Zero-rate supplies are not considered to be taxable supplies.

True or False?

4. A new car is purchased with a credit against the price for a vehicle that is traded in. GST is charged on the full purchase price, before the credit for the trade-in .

True or False?

5. If a non-registrant has taxable supplies in excess of \$30,000 in a calendar quarter, he becomes a deemed registrant as of the first sale in that quarter that pushes the total over \$30,000.

True or False?

6. If a newly acquired capital real property is used more than 50 percent for the provision of taxable supplies, the acquirer can claim 100 percent of the GST paid as an input tax credit.

True or False?

7. If a newly acquired capital personal property is used more than 50 percent for the provision of taxable supplies, the acquirer can claim 100 percent of the GST paid as an input tax credit.

True or False?

8. When the quick method is used, input tax credits on capital expenditures are tracked and dealt with in the same manner as when the regular method is used.

True or False?

9. Employees in province that does not participate in the Harmonized Sales Tax program are entitled to a GST rebate equal to 5 percent of the expenses on which GST was charged that they deducted for income tax purposes.

True or False?

10. The GST rebate on the purchase of a new home with a purchase price less than \$350,000, is equal to 36 percent of the GST paid.

True or False?

### **Retained From Previous Editions**

11. In general, transaction taxes are easy to administer and collect.

True or False?

12. One reason for using a single stage transaction tax as opposed to a multi-stage transaction tax is that it allows the government to accrue revenues at a faster pace.

True or False?

13. Providers of zero-rated goods are not allowed to claim input tax credits.

True or False?

14. Providers of health care services and providers of financial services to Canadian residents do not charge GST on their sales.

True or False?

## TIF PROBLEM TWENTY-ONE - 3

### GST/HST - Multiple Choice

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#### New For 2016/2017

##### **Transaction Tax Concepts**

1. Which of the following is not a transaction tax?
  - A. The federal GST that is assessed in Alberta.
  - B. The provincial sales tax that is assessed in Manitoba.
  - C. The tax charged for spending a day in Banff National Park.
  - D. The toll assessed for driving on Highway 407 in Toronto.

##### **Liability For GST/HST**

2. The term taxable supply, as it is used in the *Excise Tax Act*, would include all of the following except:
  - A. The sale of a new television by an unincorporated business.
  - B. The provision of electrical installation services by an electrician.
  - C. The sale of a life insurance policy by an insurance agency.
  - D. A cash free exchange of merchandise between two retail businesses.

##### **Applying The GST/HST Rate**

3. George Black lives in Manitoba, a non-participating province that has an 8 percent provincial sales tax. During the current year, he purchases a new Lexus for \$82,000. He receives a trade in allowance of \$36,000 for his old vehicle. The GST/HST charged on his new vehicle would be equal to:
  - A. \$4,100
  - B. \$2,300
  - C. \$5,980
  - D. \$10,660

##### **Collection And Remittance Of GST/HST**

4. Jasper Appliances is an Ontario HST registrant. Ontario has a 13 percent HST rate. As part of its Black Friday promotion, the store is advertising that, on that day, products can be purchased with no HST charged. On that day, a stove is sold for \$2,800, its list price with no HST added to the amount owed by the customer. How much HST would Jasper Appliances owe the government as a result of this sale?
  - A. \$322.12
  - B. Nil
  - C. \$364.00
  - D. \$133.33

**Input Tax Credits**

5. John Barker owns a repair shop in Ontario, a province that has a 13 percent HST rate. He has asked you to calculate the HST payable or refund for the first reporting period. Given the following information, what should the repair shop's HST payable or refund be?

	<b>Amount Before HST</b>
Sales	\$150,000
Equipment purchased	96,000
Supplies purchased	83,000
Wages paid	19,000
Rent paid	17,000

- A. A refund of \$8,450
- B. A payment of \$6,500
- C. A refund of \$3,770
- D. A refund of \$5,980

**Relief For Small Businesses**

6. With respect to the quick method of accounting for GST/HST, which of the following statements is **NOT** correct:
- A. The rates used to determine the GST/HST liability under the quick method depend on whether the registrant is a business that purchases goods for resale or a business that provides services.
  - B. Capital expenditures are tracked separately for purposes of determining input tax credits.
  - C. Any business can elect to use the quick method as long as annual GST/HST included taxable sales total \$400,000 or less.
  - D. Current expenditures are not tracked separately for purposes of determining input tax credits.

**Residential Property And New Housing GST Rebate**

7. In April of the current year, Bryan Lord purchases a new home at a cost of \$610,000, plus GST of \$30,500. Bryan is a resident of Manitoba, a province that does not participate in the HST program. Bryan will be eligible for a new housing GST rebate of:
- A. Nil
  - B. \$6,300
  - C. \$10,980
  - D. \$17,500

**Retained From Previous Editions**

**General GST/HST**

8. Which of the following is **NOT** correct?
- A. All persons engaged in a business must register with the CRA for GST purposes.
  - B. In a province, there can be a provincial sales tax or the HST, but not both.
  - C. Long-term residential rents are exempt from GST.
  - D. Manitoba and Saskatchewan charge GST at the same rate.

**Transaction Tax Concepts**

9. Despite several advantages of transaction taxes, such as their simplicity, they are not the only source of revenue for the federal government. Why are income taxes still used as a significant source of revenue for the government?
- A. Income taxes can be applied with greater consistency than transaction taxes.
  - B. Income taxes encourage individual initiative to work and invest, while transaction taxes discourage these activities.
  - C. Income taxes are less regressive than transaction taxes.
  - D. Income taxes result in lower income individuals paying a higher proportion of their income in taxes.
10. How does the Canadian government compensate for the regressive nature of the GST?
- A. By allowing an exemption from the tax for lower income individuals.
  - B. By ensuring that items purchased more frequently by lower income individuals are not subject to the tax.
  - C. By providing lower income individuals with GST refunds.
  - D. By providing a refundable GST tax credit that is available to lower income individuals.

**Supply Categories**

11. Which of the following is **NOT** a fully taxable supply?
- A. A bus ride from home to school.
  - B. The purchase of a litre of milk at the grocery store.
  - C. The purchase of a meal in a restaurant.
  - D. The completion of a tax return by an accounting firm.
12. Which of the following statements related to fully taxable and zero-rated supplies in a participating province is correct?
- A. Fully taxable supplies are taxed at the HST rate and zero-rated supplies are taxed at 0.0 percent. Expenditures related to both types of supplies are eligible for input tax credits.
  - B. Fully taxable supplies are taxed at the HST rate and zero-rated supplies are taxed at 0.0 percent. Input tax credits are available on only expenditures related to fully taxable supplies.
  - C. Both types of supplies are taxed at the HST rate. Input tax credits are available on only expenditures related to fully taxable supplies.
  - D. Fully taxable supplies are taxed at the HST rate and zero-rated supplies are taxed at 0.0 percent. Input tax credits are available on all expenditures related to fully taxable supplies and on only capital expenditures related to zero-related supplies.
13. Which of the following statements related to exempt and zero-rated supplies is correct?
- A. Both zero-rated and exempt supplies are taxable at 0.0 percent. Expenditures related to zero-rated supplies are eligible for input tax credits and those related to exempt supplies are not.
  - B. Zero-rated supplies are taxable at 0.0 percent, while exempt supplies are not taxable. Expenditures related to both zero-rated and exempt supplies are eligible for input tax credits.
  - C. Zero-rated supplies are taxable at 0.0 percent, while exempt supplies are not taxable. Expenditures related to zero-rated supplies are eligible for input tax credits and those related to exempt supplies are not.
  - D. Both zero-rated and exempt supplies are taxable at 0.0 percent. Neither expenditures related to zero-rated supplies nor those related to exempt supplies are eligible for input tax credits.

**Applying the GST/HST Rate**

14. In Ontario, the HST rate is 13 percent, in Alberta there is only GST of 5 percent. For which of the following transactions will the rate charged be 5 percent?
- A. A writer located in Alberta produces a book for a publisher located in Ontario and receives payment from the Ontario office.
  - B. An Ontario registrant sells a product to a resident of Alberta who is visiting Ontario.
  - C. An Alberta registrant ships a product to a recipient in Ontario.
  - D. An Ontario registrant ships a product to a recipient in Alberta.

**GST/HST Registration**

15. Marvin's Rooms is a new business which started on January 1, 2016. Its sales during its first four quarters of operation were as follows:

Quarter	Sales
1	\$13,000
2	18,000
3	24,000
4	27,000

On what date will Marvin's Rooms have to begin collecting GST?

- A. The date in the second quarter on which cumulative sales total \$30,000.
  - B. July 1, 2016.
  - C. August 1, 2016.
  - D. September 1, 2016.
16. Elfassy Art Dealers is a new business which started operating on January 1 of the current year. It had four sales on the following dates during its first year of operation:

Quarter - Date	Sales
1 - February 1	\$13,000
2 - May 1	5,000
3 - August 1	35,000
4 - November 1	27,000

On what date will Elfassy Art Dealers have to begin collecting GST?

- A. July 1.
  - B. August 1.
  - C. September 1.
  - D. November 1.
- Input Tax Credits**
17. For vendors of taxable supplies who purchase goods for resale and make capital expenditures to be used in commercial activities, input tax credits can be claimed for GST/HST billed or paid on:
- A. all capital expenditures made during the period and goods sold during the period.
  - B. a portion of capital expenditures based on their estimated service life and goods purchased for resale during the period.
  - C. a portion of capital expenditures based on their estimated service life and goods sold during the period.
  - D. all capital expenditures made during the period and goods purchased for resale during the period.
  - E. goods purchased for resale during the period, but not capital expenditures.

18. Underwater World Ltd., is located in Alberta. Alberta does not participate in the HST program and does not have a provincial sales tax. Among the purchases Underwater World Ltd. made during December were the following items:

<b>Item</b>	<b>Price Before GST</b>
New motor for Dinghy #1	\$7,000
New snorkeling equipment (for charter trips)	400
Water ski club membership fee (for the president)	700
Membership to Waterways Ltd.	500

Waterways Ltd. carries supplies for charter boat operators and requires the payment of a membership to use their services. The input tax credits that Underwater World Ltd. can claim for the above items for December are:

- A. \$350.  
 B. \$370.  
 C. \$395.  
 D. \$430.  
 E. None of the above.
19. Joel Knight, a lawyer, is a sole practitioner in the province of Ontario. The HST rate in Ontario is 13 percent. Joel has requested that you advise him on what his HST remittance should be for the October to December quarter. Details of transactions, excluding HST, between October and December are:

Revenues	\$30,000
Expenses:	
Salaries	\$ 7,000
Proprietor's drawings	11,000
Office supplies	500
Rent	3,000

The HST that is to be remitted for the October to December quarter is:

- A. \$1,105.  
 B. \$2,535.  
 C. \$3,445.  
 D. \$3,835.  
 E. None of the above.
20. Paddy's Cycle Shop operates in New Brunswick where the HST rate is 13 percent. A summary of the shop's transactions for the month of January is as follows:

<b>Account</b>	<b>Amount Before HST</b>
Revenues	\$300,000
Purchase of bicycles	150,000
Purchase of tires and other parts	18,500
Salaries	8,000
Premises rental	3,000

The HST that is to be remitted in respect of the above transactions is:

- A. \$15,665.  
 B. \$16,055.  
 C. \$16,705.  
 D. \$17,095.  
 E. None of the above.

21. You are performing a review of a lawyer's books of account. The lawyer's office is in Ontario where the HST rate is 13 percent. While you are in her office, she asks you to calculate how much her HST remittance should be. You are given the following amounts which exclude HST charged or paid.

Revenues	\$325,000
Expenses:	
Salaries	\$135,000
Stationery and supplies	5,000
Utilities - telephone and hydro	2,500
Rent	15,000

Based on the above transactions, the HST payable is:

- A. \$21,775.
  - B. \$39,325.
  - C. \$39,975.
  - D. \$41,275.
  - E. None of the above.
- Relief For Small Businesses (Quick And Streamlined Methods)**
22. With respect to the streamlined method of accounting for input tax credits in a province that does not participate in the HST program, which of the following statements is **NOT** correct?
- A. Total fully taxable inputs, with the exclusion of capital expenditures on real property, are multiplied by 5/105 to arrive at the input tax credit for the GST return.
  - B. Capital expenditures are not tracked separately for purposes of determining input tax credits.
  - C. Registrants using this method charge GST at the usual 5 percent rate on fully taxable sales.
  - D. Registrants using this method who provide both taxable and exempt goods and services must pro-rate the input tax credit claim so that only the portion that applies to taxable goods and services is claimed.
23. Kenichi Tajima operates a small clothing store in Saskatchewan, a non-participating province. The provincial sales tax is 5 percent. This store uses the streamlined method of accounting for input tax credits. The store had fully taxable purchases of \$180,000 and purchased capital items (not including real property) with a cost of \$5,000. Both amounts include PST and GST. What amount of input tax credit is Mr. Tajima able to claim?
- A. \$0
  - B. \$8,409
  - C. \$8,810
  - D. \$9,250

**GST/HST Procedures and Administration**

24. Associated persons file separate GST/HST returns, but they must combine their total taxable sales of goods and services in certain situations. A Ltd. sells 100 percent fully taxable supplies, and B Ltd. sells 100 percent zero-rated supplies. In which of the following situations would the associated small businesses A Ltd. and B Ltd. **NOT** need to combine their taxable sales?
- A. A Ltd. and B Ltd. would like to claim the full input tax credit on the purchase of a building for A Ltd.
  - B. A Ltd. and B Ltd. would like to use the small supplier's exemption.
  - C. A Ltd. and B Ltd. would like to use the quick method of accounting.
  - D. A Ltd. and B Ltd. would like to use the streamlined method for calculating input tax credits.

**Employee And Partner GST/HST Rebate**

25. A GST rebate is available to employees of a GST registrant located in a province that does not participate in the HST program. The calculation is based on a factor of 5/105 of:
- A. all taxable benefits received from their employer.
  - B. all expenses deducted in the calculation of net employment income.
  - C. all taxable benefits received from their employer and all expenses deducted in the calculation of net employment income.
  - D. all eligible expenses for fully taxable supplies deducted in the calculation of net employment income, except for capital cost allowances.
  - E. all eligible expenses for fully taxable supplies deducted in the calculation of net employment income, including capital cost allowances.
26. Tamara Soccorro is a real estate agent. She lives in a province that participates in the HST program at 13 percent. She earns commission income, and pays her employment related expenses herself. Tamara has claimed the following expenses on her T777 – Statement of Employment Expenses:

Office Supplies (100 percent)	\$1,100
Automobile gas and maintenance (87 percent)	4,176
Automobile insurance (87 percent)	3,132
CCA on car (87 percent)	5,791

Where applicable, the amounts include the HST. What is Tamara's Employee HST Rebate?

- A. \$ 607
- B. \$1,273
- C. \$1,439
- D. \$1,634

**Sale of a Business**

27. In which of the following situations will the vendor and purchaser be able to file a joint election to treat the supply as if it were zero-rated?
- A. The vendor is selling substantially all of the assets of his business. The vendor is a GST/HST registrant but the purchaser is not.
  - B. The vendor is selling the majority (60 percent) of the assets of the business. Both the vendor and the purchaser are GST/HST registrants.
  - C. The vendor is selling the shares of the business. Both the vendor and the purchaser are GST/HST registrants.
  - D. The vendor is selling substantially all of the assets of his business. Neither the vendor nor the purchaser are GST/HST registrants.

**Specific Applications**

28. A registered charity in a non-participating province has a used clothing store. Revenues from the store for the year total \$40,000. Which of the following statements is correct?
- A. The charity will have to collect GST on all of their clothing sales.
  - B. The charity will not have to collect any GST on their clothing sales.
  - C. The charity will have to collect GST on their clothing sales on revenues greater than a \$30,000 small supplier exemption.
  - D. The charity cannot claim input tax credits.

***Partnerships and GST/HST***

29. A partnership operates an engineering firm, providing fully taxable services. Which of the following statements is correct?
- A. The partners are required to register for the GST/HST with respect to the commercial activities.
  - B. The partnership is required to collect the GST/HST on taxable supplies and is eligible for input tax credits.
  - C. Partners are not individually liable for the GST/HST of the partnership.
  - D. Costs incurred by partners that are reimbursed by the partnership are eligible for the Employee and Partner GST/HST Rebate.

***Trusts and GST/HST***

30. Which of the following transactions related to the operation of a trust are subject to GST/HST?
- A. A distribution of taxable supplies by the trust to the beneficiaries.
  - B. A distribution of family jewelry by a trust to a beneficiary in the process of settling an estate.
  - C. A distribution of financial securities.
  - D. The sale of an interest in a trust by a beneficiary.

## TIF PROBLEM TWENTY-ONE - 4

### GST/HST - Exam Exercises

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#### *Exam Exercise Subject Listing For Chapter 21*

<b>Number</b>	<b>Subject</b>
1	Alternative VAT Approaches
2	Alternative VAT Approaches
3	Requirement To Register
4	Requirement To Register
5	Requirement To Register
6	Requirement To Register
7	Input Tax Credits
8	Input Tax Credits
9	GST Calculation
10	GST Calculation
11	HST Calculation
12	HST Calculation
13	Quick Method
14	Quick Method
15	Streamlined Input Tax Credit Method
16	Streamlined Input Tax Credit Method

**Exam Exercise Twenty-One - 1 (Alternative VAT Approaches)**

During the current taxation period, Mackin Enterprises purchased merchandise for \$371,000. Merchandise sales during this period totalled \$476,000 and the cost of the merchandise sold was \$302,000. Ignoring all other costs incurred by Mackin and assuming a rate of 5 percent, how much tax would be paid by Mackin under an accounts-based VAT system and under an invoice-credit VAT system?

**Exam Exercise Twenty-One - 2 (Alternative VAT Approaches)**

Brad Inc. had sales of merchandise during the current taxation period of \$825,000. The cost of the merchandise sold was \$562,000. During the period, inventories of merchandise increased by \$150,000. Without consideration of other costs incurred by Brad Inc., and using a rate of 8 percent, determine how much tax would be paid by the Company under an accounts-based VAT system and under an invoice-credit VAT system.

**Exam Exercise Twenty-One - 3 (Requirement To Register)**

Mr. Marcus Leblanc begins his business on January 1 of the current year. His quarterly sales of taxable items are as follows:

<b>Calendar Quarter</b>	<b>Taxable Sales</b>
January, February, March	\$14,000
April, May, June	6,000
July, August, September	33,000
October, November, December	50,000

At what point in time will Mr. Leblanc have to begin collecting GST? At what point will he be required to register?

**Exam Exercise Twenty-One - 4 (Requirement To Register)**

Sheila Hammer starts a new business on January 1 of the current year. Her quarterly sales of taxable items are as follows:

<b>Calendar Quarter</b>	<b>Taxable Sales</b>
January, February, March	\$28,000
April, May, June	32,000
July, August, September	21,000
October, November, December	48,000

At what point in time will Ms. Hammer have to begin collecting GST? At what point will she be required to register?

**Exam Exercise Twenty-One - 5 (Requirement To Register)**

Ms. Jesse Holt begins her business on January 1 of the current year. Her quarterly sales of fully taxable items are as follows:

<b>Calendar Quarter</b>	<b>Taxable Sales</b>
January, February, March	\$20,000
April, May, June	2,000
July, August, September	19,000
October, November, December*	42,000

\*Consists of a sale of \$28,000 on October 15 and a sale of \$14,000 on November 27.

At what point in time will Ms. Holt have to begin collecting GST? At what point will she be required to register?

**Exam Exercise Twenty-One - 6 (Requirement To Register)**

Marvin Gardens starts a new business on January 1 of the current year. During the first year of operations, quarterly sales were as follows:

<b>Calendar Quarter</b>	<b>Taxable Sales</b>
January, February, March	\$18,000
April, May, June	14,000
July, August, September*	35,000
October, November, December	37,000

\*Consists of a sale of \$15,000 on July 15, and a sale of \$20,000 on September 27.

At what point in time will Mr. Gardens have to begin collecting GST? At what point will he be required to register?

**Exam Exercise Twenty-One - 7 (Input Tax Credits - Capital Expenditures)**

Edleson Inc. is located in a province that does not participate in the HST program. During its current fiscal period, Edleson Inc. purchases an office building for \$1,450,000 (excluding GST), including a payment for the land of \$320,000. It spends an additional \$347,400 (excluding GST) for equipment to be used in the building. The building will be used 35 percent to produce fully taxable supplies and 65 percent for exempt supplies. The equipment will be used 42 percent for taxable supplies and 58 percent for exempt supplies. For accounting purposes, the building will be amortized over 30 years, while the equipment will be written off over 12 years.

Determine the input tax credits that Edleson Inc. can claim as a result of these capital expenditures.

**Exam Exercise Twenty-One - 8 (Input Tax Credits - Capital Expenditures)**

Logan Inc. is located in Ontario where a 13 percent HST is applicable. During the current year, the Company makes the following capital expenditures:

Office Building (Including HST)	\$2,825,000
Equipment (Including HST)	904,000

The building will be used 40 percent to produce fully taxable supplies and 60 percent for zero-rated supplies. The equipment will be used 35 percent for fully taxable supplies, 25 percent for zero-rated supplies, and 40 percent for exempt supplies.

Determine the input tax credits that Logan Inc. can claim as a result of these capital expenditures.

**Exam Exercise Twenty-One - 9 (GST Calculation)**

Mr. Jack Morton works in the province of Alberta, a province that does not participate in the HST program. He is a management consultant who delivers services that are billed at a GST inclusive amount of \$286,650 during the current year. Before the inclusion of any applicable GST, his expenses for the year are \$18,000 for rent, \$23,500 for clerical salaries, \$5,000 for interest on a loan, and \$3,000 for office supplies (purchases of these supplies totaled \$4,500 for the year). In addition, he acquired office furniture at the beginning of the year for \$32,000, plus GST of \$1,600. The cost of this furniture is being expensed over 10 years at a rate of \$3,200 per year.

Determine the net GST payable or refund for the year.

**Exam Exercise Twenty-One - 10 (GST Calculation)**

May Poplar lives in Alberta, a province that does not participate in the HST program. She runs a decorating business, delivering services that are billed at \$326,000, before the inclusion of GST. Her current expenses for the year are as follows (all amounts are before GST):

Rent	\$36,000
Salaries To Employees	72,000
Interest On Business Loan	5,000
Supplies	23,000
CCA	12,000

Her inventory of Supplies increased by \$4,000 during the year. In addition to these current expenditures, she acquired additional furniture and fixtures in the amount of \$18,000, before the inclusion of GST. She files her GST return on an annual basis and does not use the Quick Method.

Determine the net GST payable or refund for the year.

**Exam Exercise Twenty-One - 11 (HST Calculation)**

Ms. Mary Rivers works in the province of Ontario where the HST rate is 13 percent. She is a photographer who has billings of \$136,000 during the current year. Rent for this period on her office and darkroom totals \$29,450 and she pays an office assistant an annual salary of \$21,300. Her capital expenditures during the period are for photographic equipment with a cost of \$43,700 and computer hardware and software for \$18,000. All amounts are before the addition of HST. She files her HST return on an annual basis and does not use the Quick Method.

Determine the net HST payable or refund for the year.

**Exam Exercise Twenty-One - 12 (HST Calculation)**

Alvin Creek has a business in Nova Scotia where the HST rate is 15 percent. He is a management consultant whose business had HST included revenues of \$517,500 during the current year. His current expenses for the year are as follows (all amounts are before HST):

Rent	\$48,000
Salaries To Employees	23,000
Interest On Business Loan	5,000
Office Supplies	14,000
CCA	18,000

During the year, his inventory of office supplies decreased by \$3,000. In addition to these current expenditures, he acquired a new vehicle to be used in his business at a cost of \$45,000, before the inclusion of HST. The vehicle is used 95 percent for business purposes.

Determine the net HST payable or refund for the year.

**Exam Exercise Twenty-One - 13 (Quick Method)**

Felicia's Frocks, an unincorporated retail business, operates solely in Nova Scotia where the HST rate is 15 percent. The Quick Method remittance rates are 5.0 percent for businesses that purchase goods for resale and 10.0 percent for service providers. During the first quarter of the year, the business has sales of fully taxable items in the amount of \$42,300. Current expenses on which HST was paid amount to \$37,800. In addition, capital expenditures during this period totaled \$72,000. All of these amounts are before the inclusion of HST. The business has no activities other than the delivery of fully taxable merchandise.

Compare the HST payable (receivable) using the regular method applicable to GST/HST calculations with the amount that would be payable (receivable) using the Quick Method.

**Exam Exercise Twenty-One - 14 (Quick Method)**

Click Cameras operates in Alberta which does not participate in the HST program. The Quick Method remittance rates are 1.8 percent for businesses that purchase goods for resale and 3.6 percent for service providers. During the first quarter of the year, the business has taxable sales of \$63,400. Current expenses on which the GST was paid total \$26,275. Due to numerous burglaries, Click Cameras spends \$44,900 on a sophisticated security system. All of these amounts are before the inclusion of GST. The system is being amortized over five years on a straight line basis. The store is used exclusively for the sale of taxable merchandise.

Compare the GST payable (receivable) using the regular method applicable to GST calculations with the amount that would be payable (receivable) using the Quick Method.

**Exam Exercise Twenty-One - 15 (Streamlined Input Tax Credit Method)**

Narston Ltd. operates in Alberta which does not participate in the HST program and has no provincial sales tax. For the current year, Narston Ltd. has GST inclusive sales of \$472,500. It has purchases of merchandise and other current expenditures of \$320,000 before the inclusion of GST. Capital expenditures consisted of real property in the amount of \$85,000 and capital personal property in the amount of \$23,000. These amounts are before the inclusion of GST.

Using the streamlined method of accounting for input tax credits, calculate Narston's GST payable or refund for the current year.

**Exam Exercise Twenty-One - 16 (Streamlined Input Tax Credit Method)**

Parkway Ltd. operates in Ontario where the HST rate is 13 percent. For the current year, the Company has HST inclusive sales of \$395,500. Its various current expenses on which HST was paid totaled an HST inclusive amount of \$254,250. Also during the year, it acquired real property for an HST inclusive amount of \$113,000, and capital personal property for an HST inclusive amount of \$56,500.

Using the streamlined method of accounting for input tax credits, calculate Parkway's HST payable or refund for the current year.

## **TIF PROBLEM TWENTY-ONE - 5A**

### **GST/HST - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 21, “GST/HST”.

- A. Commercial Activity
- B. Employee And Partner GST/HST Rebate
- C. Harmonized Sales Tax
- D. Input Tax Credit
- E. Quick Method
- F. Transaction Tax
- G. Value Added Tax
- H. Zero-Rated Goods And Services

The following list contains ten potential definitions for the preceding key terms.

1. An entity who is registered to collect and remit the GST/HST.
2. A method of determining GST/HST amounts payable or receivable that is available to registrants with annual GST/HST taxable sales, including those of associated businesses, of \$400,000 or less. Specified percentages are applied to the GST/HST inclusive sales figures to determine the GST/HST payable or the refund. Input tax credits on capital expenditures are tracked separately.
3. A combined federal/provincial sales tax that is generally assessed on the same basis as the federal GST.
4. Any business or trade carried on by a person, or any supply of real property made by a person.
5. An amount, claimable by a registrant, for GST/HST paid or payable on goods or services that were acquired or imported for consumption, use, or supply in the course of the registrant’s commercial activity.
6. Goods and services that are taxable at a zero GST/HST rate. Registrants who sell such goods are eligible for input tax credits.
7. A provision that allows employees to recover the GST/HST paid on their employment related expenses.
8. A tax that is assessed on specified types of transactions.
9. Goods and services that are not subject to the GST/HST.
10. A tax based on the value added to a product at each stage of production or distribution by a particular entity.
11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM TWENTY-ONE - 5B**

### **GST/HST - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 21, “GST/HST”.

- A. Commercial Activity
- B. Employee And Partner GST/HST Rebate
- C. Harmonized Sales Tax
- D. Input Tax Credit
- E. Quick Method
- F. Transaction Tax
- G. Value Added Tax
- H. Zero-Rated Goods And Services

The following list contains 14 potential definitions for the preceding key terms.

1. An entity who is registered to collect and remit the GST/HST.
2. A method of determining GST/HST amounts payable or receivable that is available to registrants with annual GST/HST taxable sales, including those of associated businesses, of \$400,000 or less. Specified percentages are applied to the GST/HST inclusive sales figures to determine the GST/HST payable or the refund. Input tax credits on capital expenditures are tracked separately.
3. A combined federal/provincial sales tax that is generally assessed on the same basis as the federal GST.
4. Any business or trade carried on by a person, or any supply of real property made by a person.
5. An amount, claimable by a registrant, for GST/HST paid or payable on goods or services that were acquired or imported for consumption, use, or supply in the course of the registrant’s commercial activity.
6. A method of determining GST/HST amounts payable or receivable that is available to registrants with annual GST/HST taxable sales, including those of associated businesses, of \$400,000 or less. Specified percentages are applied to the GST/HST inclusive sales figures to determine the GST/HST payable or the refund. There is no separate tracking of input tax credits on either current expenditures or capital expenditures.
7. Goods and services that are taxable at a zero GST/HST rate. Registrants who sell such goods are eligible for input tax credits.
8. A provision that allows employees to recover the GST/HST paid on their employment related expenses.
9. A provincial sales tax that is harmonized with the GST by being assessed on the same goods and services.
10. A tax that is assessed on specified types of transactions.

**TIF Problem Twenty-One - 5B**  
*GST/HST - Key Term Matching (Moderate)*

11. Goods and services that are not subject to the GST/HST.
12. Goods and services that are taxable at a zero GST/HST rate. Registrants who sell such goods are not eligible for input tax credits.
13. A tax based on the value added to a product at each stage of production or distribution by a particular entity.
14. An amount, claimable by a registrant, for GST/HST paid or payable on all inputs used by the registrant to increase revenues.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM TWENTY-ONE - 6****Turnover Tax Vs. GST**

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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 \$500, plus tax, by the raw materials supplier to the manufacturer. There is a mark-up of 50 percent of the before tax cost at each subsequent turnover and the tax applies to the selling price at each turnover.

**Required:** Calculate the transaction tax rate required to raise the same amount of tax revenue as a 7 percent single stage tax at the consumer level.

## TIF PROBLEM TWENTY-ONE - 7

### GST Registration

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Name-Your-Income is a new unincorporated business which offers accounting services emphasizing the flexibility of accounting standards. During its first six calendar quarters, the following fees were recorded (in chronological order):

January Through March, 2016	\$8,500
April Through June	6,200
July Through September	7,400
October Through December	7,600
January Through March, 2017	8,400
April Through June	9,200

**Required:** Advise Name-Your-Income if registration for the GST is required and include the reasons for your answer. If required, state when GST collection should start and by what date registration must be completed.

## **TIF PROBLEM TWENTY-ONE - 8**

### **HST On Real Property Purchase**

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A new building is purchased in London, Ontario for \$5,000,000, before HST. The purchaser, Total Health Inc., provides all types of health care services and products, and is a GST/HST registrant. Sixty percent of the building will be used by Total Health Inc. employees as medical and dental offices. The remaining 40 percent will be used to house a pharmacy run and managed by Total Health Inc. staff.

The HST rate in Ontario is 13 percent.

**Required:** Calculate how much HST Total Health Inc. will pay on the purchase and the input tax credit that can be claimed.

**TIF PROBLEM TWENTY-ONE - 9****HST Input Tax Credits**

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Mrs. Archer operates a consulting business in Ontario and is an HST registrant. The HST rate in the province is 13 percent.

Her annual revenues have been increasing and will be over \$200,000 for the current year. She has elected to file quarterly HST returns. During October to December, 2016, Mrs. Archer made the following expenditures:

	<b>Cost (Before HST)</b>	<b>HST</b>
Meals With Clients	\$ 1,600	\$ 208
Country Club Membership	1,200	156
Laptop (Estimated 70% Business Use)	2,500	325
Automobile (100% Business Use)	42,000	5,460

HST was charged on all of the expenditures. The laptop was invoiced in December, but was not picked up or paid for until January, 2017.

**Required:** Determine the input tax credit that Mrs. Archer can claim in her October to December, 2016 GST/HST return.

**TIF PROBLEM TWENTY-ONE - 10****HST Payable**

Bestomer's Best Balloons is a proprietorship, operating only in Alberta, that is registered to file GST tax returns on an annual basis. Alberta does not participate in the HST program and does not have a provincial sales tax.

The following is a summary of the financial statement information for the current year. All amounts are presented without the inclusion of applicable GST.

Sales		\$69,000
Less Expenses:		
Cost Of Goods Sold	(\$12,000)	
Salaries And Wages	( 19,000)	
Operating Costs	( 14,500)	
Interest On Demand Loan	(   600)	
Interest On Mortgage	(  1,100)	
Amortization Expense	( 10,000)	
Income Taxes	(  2,000)	( 59,200)
Net Income		<u>\$ 9,800</u>

GST was paid on purchases of balloons and all operating costs. The inventory of balloons at the end of the year was \$4,000. The corresponding figure at the beginning of the year was \$3,000.

**Required:** Calculate the net GST payable or refund that Bestomer's Best Balloons will remit or receive for the current year.

## TIF PROBLEM TWENTY-ONE - 11

### HST Payable

Montagne Inc. is located in Ontario and carries on all of its business in that province. The HST rate in that province is 13 percent.

The Income Statement of Montagne Inc. for the current fiscal year ending December 31 is as follows (applicable HST has been excluded from all amounts):

Sales And Other Revenues		\$823,000
Less Expenses:		
Cost Of Goods Sold	(\$478,000)	
Amortization Expense	( 132,000)	
Salaries And Wages	( 57,000)	
Interest Expense	( 16,000)	
Other Operating Expenses	( 32,000)	( 715,000)
Income Before Taxes		\$108,000
Less: Federal And Provincial Income Taxes		( 23,000)
Net Income		\$ 85,000

Montagne is an annual filer for HST purposes.

#### Other Information:

1. Sales And Other Revenues included \$120,000 in exempt supplies and \$116,000 in zero-rated supplies. The remaining sales were fully taxable for HST purposes.
2. All of the goods sold involved the provision of either fully taxable or zero-rated supplies. During the year, inventories of these goods decreased by \$74,000. HST was paid on all goods that were purchased for resale during the year.
3. Capital expenditures for the year amounted to \$1,200,000 before HST. HST was paid on all amounts. Of this total, \$800,000 was for an office building that will be used 85 percent for the provision of fully taxable or zero-rated supplies. The remaining \$400,000 was for equipment that will be used 27 percent in the provision of exempt supplies. HST was paid on the acquisition of all assets on which amortization is being taken during the year.
4. All of the Other Operating Expenses involved the acquisition of fully taxable supplies and were acquired to assist in the provision of fully taxable supplies.
5. Of the Salaries And Wages, 32 percent were paid to employees involved in providing exempt supplies.

**Required:** Calculate the net HST payable or refund that Montagne Inc. will remit or receive for the current year.

**TIF PROBLEM TWENTY-ONE - 12****Quick Method**

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Billy Bob, Bubba, Nancy Sue and Sally Ann Cody are siblings. Each of them runs a separate unincorporated business. All of the businesses operate in Ontario where the HST rate is 13 percent. If the Quick Method is used in that province, the Ontario quick method remittance rate is 4.4 percent for a retail business and 8.8 percent for a service provider.

The siblings provide you with the following annual information for their businesses. All amounts are reported inclusive of HST. None of the sales or purchases were zero-rated or exempt, and none of the businesses made any capital expenditures during the year.

	<b>Type Of Business</b>	<b>Sales</b>	<b>Purchases</b>
Billy Bob	Guided Fishing Trips	\$ 90,400	\$ 24,860
Bubba	Fishing Equipment Sales	197,750	135,600
Nancy Sue	Cooking Equipment Sales	158,200	45,200
Sally Ann	Individualized Cooking Courses	107,350	67,800

**Required:** Recommend whether any of the businesses should use the Quick Method to calculate net HST remittances. Show your calculations.

## **TIF PROBLEM TWENTY-ONE - 13**

### **GST Payable Including Quick Method**

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Larkin Ltd. is a retail business located in Ontario. The HST rate in this Province is 13 percent. When the Quick Method is used in Ontario, the remittance rate is 4.4 percent for a retail business and 8.8 percent for a service provider.

All of the Company's revenues and expenses are incurred in Ontario. The Company has no associated business and files its HST return on an annual basis.

For the current year, its Income Statement is as follows (all amounts are without the inclusion of applicable HST):

Revenues:		
Sales Of Fully Taxable Goods	\$103,000	
Provision Of Exempt Services	38,000	\$141,000
Less Expenses:		
Cost Of Goods Sold	(\$ 63,000)	
Amortization Expense	( 9,000)	
Salaries And Wages	( 8,000)	
Rent	( 24,000)	
Interest Expense	( 4,000)	
Other Operating Expenses	( 12,000)	( 120,000)
Income Before Taxes		\$ 21,000
Less: Federal And Provincial Income Taxes		( 7,000)
Net Income		\$ 14,000

#### **Other Information:**

1. Inventories of taxable goods increased by \$6,000 during the year.
2. All of the Other Operating Expenses involved the acquisition of fully taxable supplies and were acquired to assist in the provision of fully taxable supplies.
3. Of the Salaries And Wages, 22 percent were paid to employees involved in providing exempt services.
4. A capital expenditure was made during the year at a HST inclusive cost of \$36,160. The expenditure was for equipment that will be used 60 percent for the provision of fully taxable goods. HST was paid on the acquisition of all assets on which amortization is being taken during this period.

#### **Required:**

- A. Calculate the net HST payable or refund that Larkin Ltd. will remit or receive for the current year using regular HST calculations.
- B. Determine if Larkin is eligible to use the Quick Method.
- C. Assume that Larkin is eligible to use the Quick Method at the 4.4 percent rate. Calculate the net HST payable or refund that Larkin Ltd. will remit or receive for the current year using the Quick Method.

## **TIF PROBLEM TWENTY-ONE - 14**

### **Employee GST Rebate**

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Martin Halo is employed by a large public company with all of its operations in Ontario. His employer is an HST registrant. Martin resides in Ontario.

**Other Information:**

1. Ontario participates assesses HST at a rate of 13 percent.
2. Martin is required to travel as part of his job. For this travel, he uses his own car and pays for all costs out of his own funds. He does not receive any reimbursement or allowance from his employer.
3. The car that Martin uses was purchased in January, 2015 at an HST inclusive price of \$32,770 [(113%)(29,000)]. He uses the vehicle exclusively for employment related travel. During 2015, Martin claimed \$4,916 of CCA [(30%)(1/2)(32,770)] and an HST rebate on the CCA of \$566 [(\$4,916)(13/113)]. His 2015 return was accepted as filed. Martin intends to take maximum CCA on the car for 2016.
4. In his 2016 tax return, Martin deducts the following amounts in the calculation of his net employment income:

Accommodation (Includes HST Of \$910)	\$ 7,910
Deductible Portion Of Meals And Entertainment (Includes HST Of \$780)	6,780
Automobile Costs:	
Gas And Maintenance (Includes HST Of \$1,040)	9,040
Interest On Automobile Loan	2,200
Insurance	1,400
<hr/>	
Total Deductions Excluding CCA	<hr/> \$27,330 <hr/>

**Required:** Calculate the maximum CCA that Martin can claim on his car for 2016. In addition, calculate the 2016 HST rebate that Martin will claim as a result of his deductible expenses.

## **TIF PROBLEM TWENTY-ONE - 15**

### **Streamlined GST Input Tax Credits**

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Rhapsody Music Supplies is a GST registrant operating in Manitoba. Manitoba does not participate in the HST program. It has an 8 percent non-refundable provincial sales tax (PST).

During the current calendar quarter, the following sales and expenditures were recorded. All sales were cash sales, and all expenditures were invoiced for and paid in the quarter.

	<b>Amount</b>	<b>GST</b>	<b>PST</b>	<b>Total</b>
Sales	\$24,000	\$1,200	\$1,920	\$27,120
Expenditures				
Capital Equipment	\$14,000	\$ 700	\$1,120	\$15,820
Interest	1,000	Nil	Nil	1,000
Purchases Of Inventory	6,000	300	480	6,780
Rent (GST, but no PST)	4,000	200	Nil	4,200
Salaries	4,000	Nil	Nil	4,000
Supplies	2,000	100	160	2,260
Total Expenditures	\$31,000	\$1,300	\$1,760	\$34,060

**Required:** Using the streamlined input tax credit method, determine the total input tax credit that can be claimed for the quarter and the required net GST remittance.

## TIF PROBLEM TWENTY-ONE - 16

### New Housing Rebate

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Misty Rivers lives in Alberta, a province that does not have a provincial sales tax. She is planning to buy a home in Lethbridge and, at this point, she has narrowed the choices down to the following:

**Property A** This is a house that was built and originally sold in 2008. It will cost \$346,000. Given its excellent condition, no improvements will be required.

**Property B** This is a new house that is under construction. The basic purchase price is \$314,000. However, she is planning \$34,000 in improvements, of which \$12,000 will be completed by the builder prior to the sale of the property. The remaining improvements will be completed by Misty and her partner, using materials that will cost \$22,000.

**Property C** This is an old farmhouse that has an "as is" sale price of \$275,000. The property will require major renovations, involving over 90 percent of the interior space. The vendor has agreed to carry out these renovations for an addition to the sales price of \$115,000, resulting in a total price of \$390,000.

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