Instructor's Solutions Manual

Chapter 11 – Solutions to Assignment Problems

Solution to AP 11-1

2019 Analysis

The required information can be calculated as follows:

ITA 3(a)		
Business Income	$18,000	
Taxable (Grossed Up) Dividends	2,360	$20,360
ITA 3(b)		
Taxable Capital Gains	$ 600	
Allowable Capital Losses	(2,100)	Nil
ITA 3(c)		$20,360
ITA 3(d)		
Unrestricted Farm Loss (See Note)		(6,250)
2019 Net Income and Taxable Income		$14,110

Note Ms. Breau's farm losses are restricted as follows:

Total Farm Loss		$10,000
Unrestricted Amount:		
First $2,500	($ 2,500)	
One-Half of $7,500 ($10,000 – $2,500)	(3,750)	(6,250)
2019 Restricted Farm Loss		$ 3,750

As noted in the problem, none of the losses can be carried back before 2019. This would leave the following 2019 loss carry over balances:

- 2019 Restricted Farm Loss $3,750
- 2019 Net Capital Loss [($2,100 (ITA 3(b)(ii)) – $600 (ITA 3)(b)(i))] $1,500

In this first year the taxable income is less than the required $15,000 to fully utilize available tax credits; however, there is no choice to limit any of the ITA 3 amounts to a smaller amount so as to achieve the $15,000 taxable income.

2020 Analysis

The required information can be calculated as follows:

ITA 3(a)		
Farm Income	$ 2,000	
Taxable (Grossed Up) Dividends	2,950	$4,950
ITA 3(b)		
Taxable Capital Gains	$ 1,000	
Allowable Capital Losses	Nil	1,000

ITA 3(c)	$5,950
ITA 3(d)	
Non-Farming Business Loss	(14,000)
2020 Net Income	Nil
2019 Net Capital Loss	($1,000)
2020 Taxable Income	Nil

Since there are $1,000 of net taxable capital gains this year, and the problem states that Ms. Breau would like to deduct the maximum amount of net capital losses, the net capital loss of $1,000 is applied against the ITA 3(b) amount of $1,000, which effectively increases the 2020 non-capital loss.

The 2020 non-capital loss is calculated as follows:

Business Loss	$14,000
Add: 2019 Net Capital Loss Deducted	1,000
ITA 3(c) Income	(5,950)
2020 Non-Capital Loss	$ 9,050

The entire 2020 non-capital loss could be carried back to 2019, but since Ms. Breau requires $15,000 in taxable income to fully utilize her tax credits, no carry back is contemplated.

There would be the following loss balances at the end of 2020:

- 2019 Restricted Farm Loss (Unchanged) $3,750
- 2019 Net Capital Loss ($1,500 – $1,000)] $ 500
- 2020 Non-Capital Loss $9,050

2021 Analysis

The required information can be calculated as follows:

ITA 3(a)		
Non-Farming Business Income	$30,000	
Farm Income	3,150	
Taxable (Grossed Up) Dividends	3,963	$37,113
ITA 3(b)		
Taxable Capital Gains	$ 2,000	
Allowable Capital Losses	Nil	2,000
2021 Net Income		$39,113
2019 Restricted Farm Loss (Equal to Farm Income)		(3,150)
2019 Net Capital Loss (Less than $2,000)		(500)
2020 Non-Capital Loss Carry Forward (All)		(9,050)
2021 Taxable Income		$26,413

There would be the following loss balances at the end of 2021:

- 2019 Restricted Farm Loss ($3,750 – $3,150) $ 600

2022 Analysis

The required information can be calculated as follows:

ITA 3(a)		
Taxable (Grossed Up) Dividends		$ 6,450
ITA 3(b)		
Taxable Capital Gains	$ 2,250	
Allowable Capital Losses	(7,250)	Nil
ITA 3(c)		$ 6,450
ITA 3(d)		
Non-Farming Business Loss	($19,000)	
Farm Loss	(2,000)	(21,000)
2022 Net Income and Taxable Income		Nil

The 2022 non-capital loss can be calculated as follows:

Business Loss	$19,000
ITA 3(c) Income	(6,450)
Non-Capital Loss	$12,550
Farm Loss (Unrestricted)	2,000
2022 Non-capital loss	$14,550

Although technically the farm loss is accounted for separately from the non-capital loss, since the farm loss is less than $2,500 it is treated as an unrestricted farm loss and can be applied against all types of income. Given the carry over rules are the same, we have treated this farm loss as part of the non-capital loss carry over although technically the 2022 non-capital loss would be $12,550 and the 2022 Farm loss would be $2,000. The preceding loss carry over of $14,550 is available for carry back three years to 2019.

The 2022 net capital loss would be equal to $5,000 [ITA 3)(b)(ii) $7,250 – ITA 3(b)(i) of $2,250)]. $1,500 of the 2022 net capital loss can be applied to the 2021 year as there are $1,500 ($2,000 – $500) in net taxable capital gains remaining in 2021 as the basis for a carry back. This leaves a balance of $3,500 ($5,000 – $1,500).

If both the $14,550 non-capital loss and the $1,500 net capital loss were carried back to 2021, the result would be a Taxable Income of $10,363, less than the $15,000 that is required to fully utilize Ms. Breau's available tax credits. As the 2021 net capital loss can only be deducted to the extent of net taxable capital gains, it would be advisable to first claim the full amount of this loss. Based on this view, the deduction of the 2022 non-capital loss will be limited to $9,913 ($26,413 – $15,000 – $1,500), an amount that will provide for the full use of Ms. Breau's 2021 tax credits:

2021 Taxable Income (As Reported)	$26,413
2022 Non-Capital Loss	(9,913)
2022 Net Capital Loss	(1,500)
2021 Revised Taxable Income	$15,000

These loss applications leave Ms. Breau with her required $15,000 in 2021 taxable income. The following loss balances remain at the end of 2022:

- 2019 Restricted Farm Loss $ 600
- 2022 Net Capital Loss ($5,000 – $1,500)] $3,500
- 2022 Non-Capital Loss ($14,550 – $9,913) $4,637

Solution to AP 11-2

Before consideration of any loss carry overs, Lucinda would have 2021 taxable income as follows:

Rental Income	$ 91,450
Interest Income	38,275
Taxable Capital Gains	17,300
2021 Net Income and Taxable Income	$147,025

The loss on Recovery Inc. qualifies as a Business Investment Loss (BIL) because it is a transaction to which ITA 50(1) applies. However, because of her use of the capital gains deduction in 2020, $156,000 of this amount would be disallowed as a result of ITA 39(9). Given this, the ABIL would be calculated as follows:

Total Capital Loss	$675,000
Reduced by previous Capital Gains Deduction	(156,000)
BIL	$519,000
Inclusion Rate	1/2
2022 ABIL	$259,500

Lucinda's 2022 taxable income is calculated as follows:

Income Under ITA 3(a)		
Rental Income	$86,300	
Interest Income	27,438	$113,738
Income Under ITA 3(b)		
Taxable Capital Gains	$18,620	
Allowable Capital Loss [(1/2)($156,000)] (Note 1)	(78,000)	Nil
Balance Under ITA 3(c)		$113,738
Deduction Under ITA 3(d)		
ABIL (Note 2)		(259,500)
2022 Net Income and Taxable Income		Nil

Note 1 The part of the capital loss of $675,000 that does not qualify as a BIL retains its character as a capital loss of $156,000. The allowable capital loss is therefore 50% of that amount or $78,000. As a result, there would be a 2022 net capital loss of $59,380 (ITA 3(b)(ii) $78,000 – ITA 3(b)(i)) $18,620). This 2022 net capital loss can be carried back to 2021 and applied to the extent of the net taxable capital gains of $17,300 in that year.

Note 2 As the ABIL was realized in 2022, it must be used to reduce net income for 2022. The 2022 non-capital loss would equal $145,762 (ITA 3(d) of $259,500 – ITA 3(c) of $113,738).

The amount that should be carried back to 2021 would be calculated as follows:

2021 Net Income (As Originally Calculated)	$147,025
2022 Net Capital Loss	(17,300)
2022 Non-Capital Loss	(115,917)

2021 Taxable income (equal to the 2021 BPA)	$ 13,808

As planned, these deductions would leave a 2021 taxable income of $13,808 ($147,025 – $17,300 − $115,917). The taxes on this amount will be eliminated by Lucinda's 2021 BPA. Since there was no federal income tax payable prior to 2021, there would be no additional loss carry backs. The following loss balances remain after the loss carry back applications:

2022 Net Capital Loss Carry Forward ($59,380 – $17,300)	$42,080
2022 Non-Capital Loss Carry Forward ($145,762 – $115,917)	$29,845

For the next 10 years, the ABIL will be part of the 2022 non-capital loss. Any unused amount remaining after 10 years will be transferred from the 2022 non-capital loss to a net capital loss in year 11. As a net capital loss, it may then be carried forward indefinitely.

Solution to AP 11-3

Business Investment Losses (BIL) are capital losses that meet certain conditions such as investing in "small business corporations" by either purchasing shares or lending money. Even if all of the requisite conditions are met a BIL can be reduced or eliminated altogether depending upon whether the capital gains deduction was claimed in preceding years. The effect of this reduction is to split a BIL into two components – one representing the part of the BIL not reduced and the second representing the reduction. The first part is the BIL for the year and the second part a regular capital loss for the same year. The result is calculated as follows:

2022 Capital Loss [($82,000 + $200) – $21,000]	$ 61,200
ITA 39(9) Reduction for previous years capital gains deduction ($20,000 + $14,000)	(34,000)
BIL	$ 27,200
Inclusion Rate	1/2
2022 ABIL	$ 13,600

David's 2022 net income would be calculated as follows:

ITA 3(a)			
Business Income			$110,000
Non-eligible dividends	$ 8,000		
Gross-up at 15%	1,200		9,200
ITA 3(b)			
Taxable Capital Gain [(1/2)($167,000 – $33,000 – $2,000)]		$ 66,000	
Regular Allowable Capital Loss [(1/2)($34,000)]		(17,000)	49,000
ITA 3(c)			$168,200
ITA 3(d)			
ABIL			(13,600)
2022 Net Income			$154,600

David's 2022 taxable income under the two different assumptions would be determined as follows:

	Part A	Part B
2022 Net Income	$154,600	$154,600
2018 Net Capital Loss	(5,500)	Nil
Capital Gains Deduction (Note)	(27,100)	(32,600)
2022 Taxable Income	$122,000	$122,000

Note As the only capital gains in 2022 are on QSBC shares, the simplified formula for the annual gains limit as described in the textbook can be used. Given this, the capital gains deduction is the cumulative gains limit for both Part A and B as it is the least of the following:

Amount Available The amount available would be calculated as follows:

	Part A	Part B
Amount Available [(1/2)($913,630*)]	$456,815	$456,815
Amount Used in 2013 [(1/2)($20,000)]	(10,000)	(10,000)
Amount Used in 2017 [(1/2)($14,000)]	(7,000)	(7,000)
Capital Gains Deduction Available	$439,815	$439,815

*This is the 2022 limit for gains on dispositions of QSBC shares. For gains on qualified farm or fishing property (QFP), the 2022 limit remains unchanged from 2021 at $1,000,000.

Annual Gains limit The annual gains limit would be calculated as follows:

	Part A	Part B
ITA 3(b) amount	$49,000	$49,000
ABIL Realized	(13,600)	(13,600)
2018 Net Capital Loss Deducted	(5,500)	Nil
2022 Annual Gains Limit	$29,900	$35,400

Cumulative Gains Limit The cumulative gains limit would be calculated as follows:

	Part A	Part B
Sum of Annual Gains Limits		
($10,000 + $7,000 + $29,900)	$46,900	
($10,000 + $7,000 + $35,400)		$52,400
Amounts Deducted in Prior Years		
($10,000 + $7,000)	(17,000)	(17,000)
CNIL ($12,000 – $9,200)*	(2,800)	(2,800)
Cumulative Gains Limit	$27,100	$32,600

*The CNIL is reduced by investment income, which would include any grossed-up eligible or non-eligible dividends.

In Part B, David will retain his 2018 $5,500 net capital loss balance but will have $5,500 less of his capital gains deduction available for future years. Taxable income in both cases is the same.

Solution to AP 11-4

Case 1

Neither Sam nor Sandra work the 20 hours per week that is required by the "bright line" test for an excluded business. However, they are both actively engaged in the activities of the business and this, combined with the fact that no other employees are required should satisfy the excluded business criteria. The dividends received by Sam and Sandra are not split income.

Case 2

Max and Mary are between 18 and 24 years of age and easily meet the 20 hours per week test during most of the annual period that the GoGreen business operates. The fact that they have to return to university in mid-September and cannot work in the business during the short period from that date until the business closes at the end of September would not prevent them from taking the position that they are actively engaged in the business on a continuous and substantial basis. This means that the dividends received are from an excluded business to them and are therefore not split income.

Case 3

The dividends received by Edward are not split income since the shares on which they were paid were acquired by him as a result of a breakdown in the marriage. This represents one of the general exclusions that falls within the meaning of an excluded amount.

Case 4

The dividends received by Larry are not split income as Musken is an excluded business to him. He has met the "bright line" test by being actively engaged in a continuous and substantive manner for at least five years. In addition the business is not a related business to Larry as no related individual is either directly involved in the business or owns 10% or more of the value of the company shares.

With respect to Louise, her spouse is 65 years of age and the dividends would have been an excluded amount had they been paid to him. Given this, they are not split income as ITA 120.4(1.1)(c) deems them to be an excluded amount with respect to Louise.

Based on the information provided the shares would not have qualified as excluded shares since Louise's shares do not represent 10% or more of the voting rights and FMV of the company shares.

Case 5

From Donald's point of view, Dontar is an excluded business and the shares are excluded shares. The taxable dividends he received in 2022 are not split income. In addition, for 2022 there is no related business since no related person has worked in that business in the year or owned the requisite 10% of the value of the corporation's shares.

David is not involved in the business in 2022 and he is not 25 years of age or older. In addition, he has not been involved in the business in any five years prior to 2022. Therefore, from David's point of view Dontar is not an excluded business. The excluded share

exception is also not available since he is not 25 years of age or older. If he had been 25 years old the shares would not have met the excluded share definition as they were non-voting.

David is between 18 and 24 years old and he has contributed capital to the business. Unless he can successfully argue that 5% is a reasonable return on the capital contributed to the business, the taxable dividends that are in excess of the 2% safe harbour return will be split income to him.

Solution to AP 11-5

Part A – 2022 Taxable Income

Mr. and Mrs. Bahry's 2022 taxable income would be calculated as follows:

	Mr. Bahry	**Mrs. Bahry**
OAS (See Note)	$ 7,700	$ 7,700
RPP	12,340	820
RRIF	N/A	1,000
CPP	3,690	830
Dividends Received	1,600	336
Gross Up on Dividends (38%)	608	128
Interest Income on Savings Accounts	1,239	3,500
Net Taxable Capital Gain	Nil	Nil
2022 Net Income and Taxable Income	$27,177	$14,314

Note Neither Mr. nor Mrs. Bahry would have to repay any OAS benefits as both of their net incomes are well below the 2022 threshold income of $81,761.

Mr. Bahry can elect to include Mrs. Bahry's dividends in his income under ITA 82(3) as the transfer would leave her with net income of $13,850 ($14,314 – $336 – $128). This would allow an increase in the spousal credit to $548 [$14,398 − $13,850], from $84 [$14,398 − $14,314] in the absence of an election. This would also allow Mr. Bahry to use the dividend tax credit that would have been available to Mrs. Bahry but which could not actually be used because her taxable income, and therefore her federal income tax payable, was not high enough.

Part A - Tax Credits

Mrs. Bahry excludes the $464 grossed-up taxable dividends as a result of the ITA 82(3) election. This increases the amount of personal tax credits she can transfer.

Credits Available for Transfer:		
Age		$7,898
Pension (On $820 + $1,000 only)		1,820
Total Available		$9,718
Reduced by Excess of:		
Mrs. Bahry's Net Income	($13,850)	
Over BPA	14,398	Nil
Credit Base Transferred to Spouse		$9,718

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

BPA	$14,398
Spousal Credit ($14,398 − $13,850)	548
Age (No Reduction Required)	7,898
Pension	2,000
Transfers from Mrs. Bahry (see preceding calculation)	9,718
Credit Base	$34,562
Rate	15%
Total	$ 5,184
Dividend Tax Credit [(6/11)($608)]	332
Dividend Tax Credit [(6/11)($128)]	70
Charitable Donations (See Note) [(15%)($200) + (29%)($1,210 + $300 – $200)]	410
Total Credits	$ 5,996

Note Charitable donations can be claimed by either spouse, as long as the total donations are less than 75% of the claiming spouse's net income. As Mrs. Bahry has no federal income tax payable, Mr. Bahry will claim her charitable donations. It is usually advantageous for one spouse to claim all the charitable donations if they total more than $200 as the low rate of credit is only applied once.

Part A - Loss Carry Overs

Neither Mr. Bahry's allowable capital loss of $1,988 [(1/2)($3,975)] nor Mrs. Bahry's allowable capital loss of $160 [(1/2)($820 – $500)] can be deducted in 2022. As a result, they become 2022 net capital losses to each of them that can be carried back three years or carried forward indefinitely to be applied against net taxable capital gains (the ITA 3(b) amount).

Part B - Pension Income Splitting

Since Mr. and Mrs. Bahry are both in the lowest federal income tax bracket of 15% and neither has any OAS clawback, the optimum use of pension income splitting would accomplish the following objectives:

- it would permit Mrs. Bahry to fully utilize her dividend tax credit, and
- it would permit Mrs. Bahry to fully utilize her pension income tax credit.

Based on the facts however Mrs. Bahry would not pay any federal income tax and neither would Mr. Bahry since, with the ITA 82(3) election, his 2022 taxable income would be $27,641 [$27,177 + $464]. At a tax rate of 15% the gross federal income tax payable would be $4,146 [(15%)($27,641)] which is less than his total credits of $5,996. Pension splitting would not improve this result.

Solution to AP 11-6

Regular Part 1 2022 Federal Income Tax Payable

The minimum regular 2022 taxable income and 2022 federal income tax payable calculations would be as follows:

	Milana	Albert	Therese
Business Income	$120,000	$ Nil	$ Nil
Employment Income	Nil	26,000	60,000
Eligible Dividends Received	Nil	Nil	25,000
Dividend Gross Up (38%)	Nil	Nil	9,500
Non-Eligible Dividends Received	Nil	94,000	Nil
Dividend Gross Up (15%)	Nil	14,100	Nil
Taxable Capital Gains	140,000	180,000	500,000
Retiring Allowance	80,000	Nil	Nil
RRSP Deductions (Note 1)	(46,000)	(3,960)	(31,000)
ABIL	Nil	Nil	(60,000)
2022 Net Income	$294,000	$310,140	$503,500
Capital Gains Deduction	Nil	(100,000)	(440,000)
Non-Capital losses	(173,000)	(60,000)	Nil
2022 Taxable Income	$121,000	$150,140	$ 63,500
Federal Tax (Note 2)	$ 23,178	$30,755	$ 10,257
BPA (Note 3)	(1,908)	(1,908)	(1,908)
Dividend Tax Credit			
(9/13 of Gross Up)	Nil	(9,762)	Nil
(6/11 of Gross-Up)	Nil	Nil	(5,182)
2022 Federal Income Tax Payable	$ 21,270	$ 19,085	$ 3,167

Note 1 Albert's 2022 RRSP deduction room is calculated as follows:

Lesser of:	
2022 RRSP Dollar Limit = $29,210	
18% of 2021 Earned Income of $22,000 = $3,960	$3,960
Less 2021 PA	Nil
2022 RRSP Deduction Limit	$3,960

Although he contributed $5,000, his RRSP deduction is limited to $3,960 and he has $1,040 ($5,000 – $3,960) in undeducted contributions that can be carried forward and deducted in a subsequent year in which there is sufficient RRSP deduction room. Albert will not be subject to the penalty tax for overcontributions since the amount is not in excess of $2,000.

Therese's 2022 RRSP deduction room is calculated as follows:

Unused Deduction Room - End of 2021	$21,000
Annual Addition - Lesser of:	
2022 RRSP Dollar Limit = $29,210	
18% of 2021 Earned Income of $120,000 = $21,600	21,600
Less 2021 PA	(11,600)
2022 RRSP Deduction Limit	$31,000
Un-deducted Contributions from Previous Years	(8,000)
2022 Maximum RRSP Contribution	$23,000

Therese's RRSP deduction is limited to $31,000. Since she has undeducted contributions of $8,000 from previous years her deductible additional contribution for 2022 is restricted to $23,000. As she contributed $24,000 the additional $1,000 amount can be carried forward

as an undeducted contribution deductible in future years as additional contribution room is generated. Therese will not be subject to the penalty tax for over-contributions since the amount is not in excess of $2,000.

Note 2 The federal Tax Payable, before the dividend tax credit, was calculated as follows:

	Taxable Income	Federal Tax Calculations	Federal Tax
Milana	$121,000	$17,820 + (26%)($20,608)	$23,178
Albert	$150,140	$17,820 + (26%)($49,748)	$30,755
Therese	$ 63,500	$7,530 + (20.5%)($13,303)	$10,257

Note 3 Since the 2022 net income of all three individuals is more than $221,708 the BPA for each is $1,908 [$12,719 × 15%].

AMT Payable

The AMT calculations would be as follows:

	Milana	Albert	Therese
Regular Taxable Income	$121,000	$150,140	$ 63,500
60% of Taxable Capital Gains (Note 4)	84,000	108,000	300,000
60% of ABIL (Note 4)	Nil	Nil	(36,000)
Dividend Gross Up	Nil	(14,100)	(9,500)
Adjusted Taxable Income	$205,000	$244,040	$318,000
AMT Exemption	(40,000)	(40,000)	(40,000)
AMT Base	$165,000	$204,040	$278,000
Rate	15%	15%	15%
Federal AMT before Credit	$ 24,750	$ 30,606	$ 41,700
BPA	(1,908)	(1,908)	(1,908)
Federal AMT	$ 22,842	$ 28,698	$ 39,792
Regular Federal Income Tax Payable	(21,270)	(19,085)	(3,167)
Additional Income Tax Required	$ 1,572	$ 9,613	$ 36,625

Note 4 There are two acceptable methods for determining the addition for capital gains or the deduction for ABIL. Either one may be used:

- multiplying the "capital gain" or the "business investment loss" by 30%

OR

- multiplying the "taxable capital gain" or "allowable business investment loss" by 60%.

The excess of AMT over regular federal income tax payable for each of Milana, Albert, and Therese can be carried forward for seven years and applied against any future excess of federal income tax payable over the AMT for that year.

Bonus Question Solution: There are a number of methods that can be used to reduce or eliminate an AMT liability altogether. It is important, however, to keep in mind that the AMT is recoverable over the subsequent seven years albeit without interest. If it is anticipated that Part 1 federal income tax will exceed any potential AMT liability over that period of time to recover the amount in full, then it may be preferable to wait it out. If, however, the AMT

creates cash flow difficulties or it is unlikely that the AMT carry over could be recovered, then strategies should be explored to reduce or eliminate the AMT before it arises.

While there are many strategies, some of the more common include avoiding excess optional deductions such as RRSP deductions or non-capital loss claims, both of which reduce Part 1 federal income taxes. Another common strategy is to claim capital gain reserves where possible, which reduces the impact of adding back 60% of taxable capital gains, particularly where those gains have not been subject to Part 1 tax because of the capital gains deduction. A further option where there is flexibility as to the type of income such as between salary/bonuses and dividends is to choose salary over dividends. While this latter strategy will not eliminate the total federal income tax, it will increase Part 1 tax with a corresponding reduction in the AMT.

Milana – Analysis: In Milana's case she claimed all her non-capital losses of $173,000 and reduced her Part 1 tax significantly. This would have been fine had she not had to include an addition for the capital gain in determining her AMT. Milana could have avoided the AMT by claiming a smaller amount of non-capital losses. Had she limited her non-capital loss deduction to approximately $160,000 there would not have been an AMT liability.

Albert – Analysis: Given the flexibility of being the sole shareholder of his own CCPC, Albert could have reduced his AMT by opting for a greater amount of salary instead of dividends. Had he opted to take $120,000 in salary/bonus instead of dividends he would have reduced his AMT by approximately $6,000, although his Part 1 tax would have increased by the same amount. The additional salary would have increased his ability to contribute and deduct a larger contribution to his RRSP. Albert could also have opted not to claim any non-capital losses. This strategy would also have shifted the AMT liability to Part 1 income tax. Finally, Albert could have structured the capital gain transaction to be in a position to be able to claim capital gain reserves. That particular strategy would have reduced his AMT and immediate Part 1 liability.

Therese – Analysis: Options available for Therese to reduce the additional tax of $36,561 created by the AMT are to (1) reduce her RRSP deduction, (2) claim a smaller amount for the capital gains deduction, and (3) structure the capital gain transaction to enable her to claim capital gains reserves. If Therese were eligible to spread the $500,000 taxable capital gain equally over five years and limit her capital gains deduction to approximately $15,000, her AMT liability would have been reduced to nil.

Solution to AP 11-7

Deemed Dispositions Immediately before Death

Under ITA 70(5), there is a deemed disposition of all of the capital property of an individual immediately prior to the moment of death. In general, the deemed POD is the FMV of the property.

There is, however, an exception to this rule provided by ITA 70(6). Under this provision, if the transfer is to a spouse, common-law partner, or a trust in favour of a spouse or common-law partner, the deemed POD will be the tax cost of the property, ACB for non-depreciable capital property, and UCC for depreciable property.

With respect to this exception, the executor of the estate can elect out of ITA 70(6) and use the values that would apply in ITA 70(5). This results in the use of deemed POD based on FMV, thereby resulting in income tax consequences that will be reported on the deceased

individual's final income tax return. As stated in the problem, Rachelle's will instructs the executor to opt out of the ITA 70(6) spousal rollover.

Any property inherited by Rachelle's daughter would not be exempt from the usual deemed disposition rules on death as there is no rollover that applies to the properties she inherits.

Business Income
Rachelle's Business Income is calculated as follows:

Business Income	$69,400
Recapture on sale of depreciable property (Given)	5,900
2022 Business Income	$75,300

Property Income
Rachelle's property income is calculated as follows:

Interest Attributed from Martin (Note 1)	$ 876
Rental Income ($46,300 – $31,400)	14,900
Recapture on Rental Property ($210,000 – $174,795)	35,205
Eligible Dividends	860
Gross Up on Eligible Dividends [(38%)($860)]	327
Non-Eligible Dividends	6,200
Gross Up on Non-Eligible Dividends [(15%)($6,200)]	930
2022 Property Income	$59,298

Note 1 The interest income received by Martin was earned on a guaranteed investment certificate given to him by Rachelle and, as a consequence, it would be attributed to her up until the day of her death. As she died 188 days into the year, the attributed amount is $876 [(188/365)($1,700)]. As attribution from a spouse ceases when the transferor spouse dies, the remaining $824 ($1,700 – $876) would be included in Martin's income. When this is combined with his $2,100 salary, his total 2022 net income is $2,924. His income for the whole year, not just prior to Rachelle's death, will decrease the spousal credit available on Rachelle's final income tax return.

Net Taxable Capital Gains
Rachelle's net taxable capital gains are calculated as follows:

Rental Property - Land ($112,000 – $102,000)		$10,000
Rental Property - Building ($243,000 – $210,000)		33,000
RAF Ltd. Shares (Note 2)		Nil
Flax Fittings Inc. Shares ($104,000 – $72,000)		32,000
Principal Residence ($507,000 – $382,600)		124,400
Principal Residence Exemption (100%)		(124,400)
Listed Personal Property:		
Gain on Art ($57,000 – $23,400)	$33,600	
Loss on Jewelry ($32,000 – $8,300)	(23,700)	
Listed Personal Property Loss (Note 3)	(5,400)	4,500
Taxable Capital Gains		$79,500
Inclusion Rate		1/2

2022 Net Taxable Capital Gains	$39,750

Note 2 Donations of publicly listed securities benefit from special rules that make gifting these types of shares particularly attractive. While a donor is entitled to a donations tax credit based on the full FMV of such property, ITA 38(a.1) deems the capital gain on gifts of publicly listed securities to be nil.
Note 3 The listed personal property loss decreases the net gain on listed personal property in the calculation of net income. All of the carry forward amount can be claimed as it is less than the net capital gains on listed personal property for the year of $9,900 [$33,600 – $23,700].

2022 Net Income
Rachelle's 2022 net income would be calculated as follows:

Business Income	$ 75,300
Property Income	59,298
Net Taxable Capital Gains	39,750
Other Income - RRSP (Tax Free Transfer to Spouse)	Nil
Deductible CPP Contributions	
[(2)($3,500) – $3,039]	(3,961)
2022 Net Income	$170,387

2022 Taxable Income
Rachelle's 2022 taxable income would be calculated as follows:

2022 Net Income	$170,387
2020 Net Capital Loss (Note 4)	(89,400)
2022 Taxable Income	$ 80,987

Note 4 In the year of death, net capital losses can be deducted against any type of income, not just capital gains (as long as the capital gains deduction has not been claimed in previous years). As a result, all the available net capital loss balance can be deducted.

2022 Federal Income Tax Payable
Rachelle's minimum 2022 federal income tax payable would be calculated as follows:

Tax on First $50,197		$ 7,530
Tax on Remaining $30,790 ($80,987 – $50,197) at 20.5%		6,312
Federal Tax before Credits		$ 13,842
BPA	($14,398)	
Spousal ($14,398 − $2,924) (See Note 1)	(11,474)	
CPP	(3,039)	
Credit Base	($28,911)	
Rate	15%	(4,337)
Eligible Dividend Tax Credit [(6/11)(38%)($860)]		(178)
Non-Eligible Dividend Tax Credit [(9/13)(15%)($6,200)]		(644)
Charitable Donation (Note 5)		
[(15%)($200) + (29%)($28,600 − $200)]		(8,266)

2022 Federal Income Tax Payable	$ 417

Note 5 As none of her income is subject to the 33% income tax bracket, this rate will not be applicable to the calculation of the charitable donations tax credit.

Solution to AP 11-8

Part A

Lyla's 2022 Federal Income Tax Payable

Lyla's 2022 net income and taxable income would be calculated as follows:

Salary	$270,000
Group Disability Plan	Nil
RPP Contributions	(12,450)
Deductible CPP ($3,500 – $3,039)	(461)
2022 Net Income and Taxable Income	$257,089

As Lyla has no other income and no taxable income deductions her 2022 net income is equal to her taxable income. Given this, her 2022 federal income tax payable would be calculated as follows:

Tax on First $221,708		$51,345
Tax on Next $35,381 ($257,089 – $221,708) at 33%		11,676
Income Tax Payable (Before Credits)		$63,021
BPA	($12,719)	
Spousal (Income too High)	Nil	
EI Premiums	(953)	
CPP Contributions	(3,039)	
Canada Employment	(1,287)	
Medical Expenses (Note 1)	(78,521)	
Credit Base for Personal Tax Credits	($96,519)	
Rate	15%	(14,478)
Charitable Donations (Note 2)		(52,138)
2022 Federal Income Tax Payable		Nil

Note 1 The base for the medical expense tax credit, after taking into consideration the 100% coverage of Canadian medical expenses, would be calculated as follows:

Total Expenses	
($70,200 + $10,800 + $4,800 – $4,800)	$81,000
Lesser Of:	
[(3%)($257,089)] = $7,713	
2022 Limit = $2,479	(2,479)
Medical Expense Credit Base	$78,521

Because a doctor has indicated the required treatment was not available in a reasonable period of time, the travel expenses associated with the surgery would be included in the

base for the medical expense tax credit.

Note 2 The charitable donations tax credit would be calculated as follows:

15% of $200	$ 30
33% of the lesser of:	
$175,000 – $200 = $174,800	
$257,089 – $221,708 = $35,381	11,676
29% of $139,419 [$175,000 – ($200 + $35,381)]	40,432
Total Donation Credit	$ 52,138

Clark's property income would be calculated as follows:

Interest	$ 28,600
Eligible Dividends	136,000
Eligible Dividends Gross Up [(38%)($136,000)]	51,680
Net Taxable Capital Gains	77,000
Mortgage Interest*	(12,000)
2022 Net Income and Taxable Income	$281,280

*As the direct use of the mortgage funds was for investments, the interest is deductible against the investment source of income.

As Clark has no other income and no taxable income deductions his property income and net taxable capital gains would be both his 2022 net income and his taxable income. Given this, his 2022 federal income tax payable would be calculated as follows:

Tax on First $221,708		$ 51,345
Tax on Next $59,572 ($281,280 – $221,708) at 33%		19,659
Gross Tax Payable		$ 71,004
BPA	($12,719)	
Spousal (Income too High)	Nil	
Credit Base for Personal Tax Credits	($12,719)	
Rate	15%	(1,908)
Dividend Tax Credit [(6/11)(38%)($136,000)]		(28,189)
2022 Federal Income Tax Payable		$ 40,907

Combined 2022 Federal Income Tax Payable

The couple's combined 2022 federal income tax payable, assuming the Lyla claims all of the medical expenses and charitable donations, would be as follows:

Lyla's Federal Income Tax Payable	Nil
Clark's Federal Income Tax Payable	$40,907
Combined 2022 Federal Income Tax Payable	$40,907

Part B

Lyla's 2022 Federal Income Tax Payable

If Lyla did not claim the medical expenses and charitable donation amounts, her 2022 taxable income would be unchanged from Part A. Based on this, her federal income tax payable would be calculated as follows:

Tax on First $221,708		$ 51,345
Tax on Next $35,381 ($257,089 – $221,708) at 33%		11,676
Income Tax Payable (Before Credits)		$ 63,021
BPA	($12,719)	
Spousal (Income too High)	Nil	
EI Premiums	(953)	
CPP Contributions	(3,039)	
Canada Employment	(1,287)	
Credit Base For Personal Credits	($17,998)	
Rate	15%	(2,700)
2022 Federal Income Tax Payable		$ 60,321

If Clark claims the medical and charitable donations amounts, his taxable income would be unchanged from Part A. Based on this, his federal income tax payable would be calculated as follows:

Tax on First $221,708		$ 51,345
Tax On Next $59,572 ($281,280 – $221,708) at 33%		19,659
Income Tax Payable (Before Credits)		$ 71,004
BPA	($12,719)	
Spousal (Income too High)	Nil	
Medical Expense Tax Credit (Note 3)	(78,521)	
Credit Base For Personal Credits	($91,240)	
Rate	15%	(13,686)
Dividend Tax Credit [(6/11)(38%)($136,000)]		(28,189)
Charitable Donations Tax Credit (Note 4)		(53,075)
2022 Federal Income Tax Payable		Nil

Note 3 The base for this credit would not be changed from Part A when Lyla claimed the expenses. The calculation is as follows:

Total Expenses ($70,200 + $10,800 + $4,800 – $4,800)	$81,000
Lesser Of:	
[(3%)($281,280)] = $8,438	
2022 Limit = $2,479	(2,479)
Medical Expense Credit Base	$78,521

Note 4 Clark's charitable donations tax credit would be calculated as follows:

15% of $200	$ 30
33% of the lesser of:	
$175,000 – $200 = $174,800	
$281,280 – $221,708 = $59,572	19,659
29% of $115,228 [$175,000 – ($200 + $59,572)]	33,416
Total Donation Credit	$53,105

Combined 2022 Federal Income Tax Payable

The couple's combined 2022 federal income tax payable, assuming that Clark claims all of the medical expenses and charitable donations, would be as follows:

Lyla's Federal Income Tax Payable	$60,321
Clark's Federal Income Tax Payable	Nil
Combined 2022 Federal Income Tax Payable	$60,321

Part C

The combined net federal tax payable in Part B is $19,414 ($60,321 – $40,907) higher than in Part A. This is despite the fact that Clark's charitable donation credit is $967 ($53,075 – $52,108) larger than Lyla's.

The difference is due to unused credits. In Part A, $3,565 in credits available to Lyla are not used. In Part B, $23,946 in credits available to Clark are not used.

In looking to reduce combined 2022 federal income tax payable, three things should be noted:

- While the value of the medical expense tax credit is the same without regard to who claims it, it would be better for Lyla to make the claim as it would not leave any unused credits for her since her net income is less than that of Clark.
- With respect to the charitable donations credit, as Clark has the higher taxable income, a larger amount of the donation is eligible for a credit based on 33%.
- When the entire donation is claimed by either individual, a significant part of the claim results in a credit based on the 29% rate, $139,419 when Lyla claims the entire amount, and $115,228 when Clark claims the entire amount.

This would suggest that Lyla should claim all of the medical expenses and $35,581 ($257,089 – $221,708 + $200) of the donations. Based on this, her 2022 federal income tax payable would be as follows:

Tax on First $221,708		$ 51,345
Tax on Next $35,381 ($257,089 – $221,708) at 33%		11,676
Income Tax Payable (Before Credits)		$ 63,021
BPA	($ 12,719)	
Spousal (Income too High)	Nil	
EI Premiums	(953)	
CPP Contributions	(3,039)	
Canada Employment	(1,287)	
Medical Expenses (As in Part A and B)	(78,521)	
Credit Base for Personal Credits	($ 96,519)	
Rate	15%	(14,478)
Charitable Donations (Note 5)		(11,706)
2022 Federal Income Tax Payable		$36,837

Note 5 The charitable donations tax credit would be calculated as follows:

15% of $200	$ 30
33% of the lesser of:	

$35,581 – $200 = $35,381	
$257,089 – $221,708 = $35,381	11,676
29% of Nil [$35,581 – ($200 + $35,381)]	Nil
Total Donation Credit	$11,706

This would leave $139,419 ($175,000 – $35,581) of the donations to be claimed by Clark. Based on this, his 2022 federal income tax payable would be calculated as follows:

Tax on First $221,708		$ 51,345
Tax on Next $59,572 ($281,280 – $221,708) at 33%		19,659
Income Tax Payable (Before Credits)		$ 71,004
BPA	($12,719)	
Spousal (Income too High)	Nil	
Credit Base for Personal Tax Credits	($12,719)	
Rate	15%	(1,908)
Dividend Tax Credit [(6/11)(38%)($136,000)]		(28,189)
Charitable Donations Tax Credit (Note 6)		(42,787)
2022 Federal Income Tax Payable		$ Nil

Note 6 Clark's charitable donations tax credit would be calculated as follows:

15% of $200	$ 30
33% of the lesser of:	
$139,419 – $200 = $139,219	
$281,280 – $221,708 = $59,572	19,659
29% of $79,647 [$139,419 – ($200 + $59,572)]	23,098
Total Donation Credit	$ 42,787

Combined 2022 Federal Income Tax Payable

The couple's combined 2022 federal income tax payable, for all three parts, would be as follows:

	Part A	**Part B**	**Part C**
Lyla's Federal Income Tax Payable	Nil	$60,321	$36,867
Clark's Federal Income Tax Payable	$40,907	Nil	Nil
Combined 2022 Federal Income Tax Payable	$40,907	$60,321	$36,867

The combined 2022 federal income tax payable in Part C is less than that for Part A and a significant improvement over the combined federal income tax payable in Part B.

While we do not have sufficient information to pursue this alternative, a still better result might be achieved if part of the donations were carried over to a subsequent year. Even under the improved solution in Part C, the credit related to $79,647 of the donation was calculated at 29%. If Lyla and Clark expect to have taxable income amounts in excess of the 33% threshold and they do not expect to make large donations in the future, any carry forward amount could result in a credit based on 33% rather than the 29% applicable for 2022.

We would also note that in Part C Clark has $1,880 of unused tax credits, suggesting that additional donations of $6,483 [$1,880 ÷ 0.29] should be claimed by Lyla and reduced in Clark's return. The reduction in Clark's donation by that amount would reduce the donations that apply the 29% rate by $1,880, utilizing the unused tax credits while at the same time increasing the donation credit by that same amount to Lyla, thus reducing her 2022 federal income tax payable to $34,987 [$36,867 - $1,880].

Tax Planning Note

Although it is not required by the problem, it could be tax advantageous for Clark to donate public company shares from his portfolio rather than cash. If he has public company shares the ACB of which is less than the FMV at the time of donation, he would be able to reduce his present and/or future income tax liability.

Solution to AP 11-9

2021 Net Income and Taxable Income

Ms. Arsenault's minimum 2022 net income and taxable income would be calculated as follows:

Employment Income		
Gross Salary - Ottawa	$82,000	
RPP Contributions - Ottawa	(2,500)	
Stock Option Benefit (Note One)	10,000	
Gross Salary - Toronto	13,000	
RPP Contributions - Toronto	(650)	
Moving Allowance (Note Two)	7,500	$109,350
Business and Property Income		
Non-Eligible Dividends on Lintz Shares	$ 7,500	
Gross Up [(15%)($7,500)]	1,125	
Non-Eligible Dividends on Gifted Shares	10,000	
Gross Up [(15%)($10,000)]	1,500	
Deduction for Split Income (Note Three)	(11,500)	
Mail Order Business (Note Four)	22,500	31,125
Other Income (Subdivision d)		
Child Support (Note Six)		Nil
Net Taxable Capital Gains		
Lintz Shares [(1/2)($105,000 – $95,000 – $850)]	$ 4,575	
Employer's Shares (Note Five)	(175)	4,400
Other Deductions (Subdivision e)		
Moving Expenses (Note Two)	($ 5,160)	
Child Care Expenses (Note Seven)	(7,660)	
RRSP Contributions (Note Eight)	(10,098)	
Deductible CPP Contributions ($3,500 – $3,039)	(461)	(23,379)
2022 Net Income		$121,496
Stock Option Deduction (Note One)		(5,000)
2022 Taxable Income		$116,496

Note One The required inclusion would be calculated as follows:

FMV at Exercise [($20)(2,000 Shares)]	$40,000
Cost of Shares [($15)(2,000 Shares)]	(30,000)
Stock Option Benefit	$10,000

As the option price at the time the options were issued was greater than the FMV of the shares at that time, Ms. Arsenault is entitled to a deduction under ITA 110(1)(d), equal to one-half of the $10,000 employment income benefit. The new stock option deduction restrictions would not apply since the stock option plan was granted before July 1, 2021.

Note Two All allowances received from an employer, except for those that are specifically exempted, must be included in employment income. As there is no exemption for a moving expense allowance, the $7,500 received by Ms. Arsenault must be added to income. However, she can then deduct the following moving expenses in the calculation of 2022 net income:

Moving Company Charges	$3,800
Airfare for Toronto Trip (Not Deductible)	Nil
Meals and Lodging on Toronto Trip (Not Deductible)	Nil
Gas for October 31 Move to Toronto	65
Lodging in Ottawa on October 30	110
Meals on October 30 and October 31 while Moving	250
Lease Cancellation Charges	935
Legal Fees on Acquisition of Toronto Home (Not Deductible)	Nil
Total	$5,160

From an income tax perspective, this situation should have been structured differently. By giving an allowance not based on actual expenses, the employer placed Ms. Arsenault in the position of having to list her expenses. As a consequence, she was limited to those deductions specified in ITA 62(3). The result is a net inclusion in income of $2,340 ($7,500 – $5,160). As an alternative, the employer could have reimbursed her for all of the expenses listed in the problem, without creating a taxable benefit for Ms. Arsenault. This would have cost the employer less than $7,500 and, in addition, Ms. Arsenault would have avoided the additional income of $2,340. The legal fees on the new home are not deductible because she did not own a home in the old location.

Note Three Ms. Arsenault is a specified individual with respect to her father's CCPC, which is a related business. As Ms. Arsenault has never been involved in her father's business, with respect to her, it is not an excluded business. Further, her shares are non-voting and cannot be classified as excluded shares. Given this, they are subject to the Tax on Split Income (TOSI).

Note Four The interest on the demand loan is a deductible business expense and does not require any adjustment. The $27,000 withdrawal would have no income tax consequences to an individual carrying on a business as a sole proprietor.

Note Five For shares acquired through the exercise of stock options, the ACB is the FMV of the shares at the time of exercise. As a consequence, the allowable capital loss arising on the disposition of the employer's shares is calculated as follows:

POD [($20)(2,000 Shares)]		$40,000
Less:		
ACB [($20)(2,000)]	($40,000)	
Selling Costs	(350)	(40,350)
Capital Loss		($350)
Inclusion Rate		1/2
Allowable Capital Loss		($175)

Note Six Ms. Arsenault cannot deduct the $2,500 in legal fees paid in connection with her separation agreement. However, as her husband will not be able to deduct the $25,000 lump sum payment, it does not have to be included in her income. The $48,000 [($4,000)(12 Months)] in child support will not be deductible to her husband and will be excluded from her net income.

Note Seven The deductible child care expenses of $7,660 is the least of:

• Actual Child Care Expense Plus Deductible Camp Fees [$7,160 + ($125 Limit)(4 Weeks)]	$ 7,660
• Annual Limit ($11,000 for Janine + $5,000 for Jerry)	16,000
• Two-Thirds of Earned Income [(2/3)($82,000 + $10,000 + $13,000 + $7,500 + $22,500)]	90,000

Note Eight Ms. Arsenault's maximum deductible RRSP contribution is calculated as follows:

Unused Deduction Room - End of 2021	Nil
Lesser of:	
• 2022 RRSP Dollar Limit = $29,210	
• 18% of 2021 Earned Income of $81,100 = $14,598	$14,598
Less 2021 PA	(4,500)
Maximum Deductible RRSP Contribution for 2022	$10,098

2022 Federal Income Tax Payable

The TOSI Payable is calculated as follows:

Split Income – Taxable Non–Eligible Dividends (Note Three)	$11,500
Tax Rate	33%
Federal TOSI Payable before Dividend Tax Credit	$ 3,795
Non-Eligible Dividend Tax Credit [(9/13)(15%)($10,000)]	(1,038)
TOSI Payable	$ 2,757

The amount owing is calculated as follows:

Tax on First $100,392		$17,820
Tax on Next $16,104 ($116,496 – $100,392) at 26%		4,187
Federal Income Tax before Credits		$22,007
BPA	($14,398)	
Eligible Dependant – Jerry (Note Nine)	(14,398)	
Canada Caregiver – Janine (Note Ten)	(7,525)	
CPP	(3,039)	
EI	(953)	
Canada Employment	(1,287)	
Transfer of Janine's Disability	(8,870)	
Medical Expenses (Note Eleven)	(15,191)	
First Time Home Buyers' Plan	(5,000)	
Credit Base	($70,661)	
Rate	15%	(10,599)
Non-Eligible Dividend Tax Credit [(9/13)($1,125)]		(779)
Charitable Donations		
[(15%)($200) + (29%)($1,500 – $200)]		(407)
Political Contributions Tax Credit		
[(3/4)($400) + (1/2)($350) + (1/3)($150)]		(525)
2022 Federal Income Tax Payable		$ 9,697
2022 TOSI Payable (See Previous Calculation)		2,757
CPP Overpayment ($3,500 + $500 – $3,500)		(500)
EI Overpayment ($953 + $390 – $953)		(390)
Amount Owing to the CRA		$11,564

Note Nine Although Ms. Arsenault can claim either Jerry or Janine as an eligible dependant, she should pick Jerry because he has no net income in 2022. This allows for the maximum eligible dependant credit.

Note Ten Because Janine is disabled and her income is below the income threshold for the Canada caregiver credit, Ms. Arsenault can claim the full amount of the Canada caregiver base for her.

Note Eleven Because Janine is over 18, the medical expense credit for needs to be calculated separately from Ms. Arsenault and Jerry. Ms. Arsenault can still claim a credit for Janine because she is a disabled dependant.

Ms. Arsenault and Jerry's Medical Expenses ($9,700 + $900)		$10,600
Threshold - Lesser of:		
• [(3%)($121,496)] = $3,645		
• 2022 Limit = $2,479		(2,479)
Subtotal		$ 8,121
Janine's Medical Expense	$7,250	
Reduced by the Lesser of:		
• [(3%)($6,000)] = $180		
• 2022 Limit = $2,479	(180)	7,070
Allowable Medical Expenses		$15,191

Solution to AP 11-10

Part A - Bert's Results

2022 Net Income

Note: If both the TOSI and attribution rules would apply to the same amount a rule in ITA 74.5(13) ensures that only the TOSI will apply. However, since the shares were owned by Bert and acquired with his own funds the attribution rules would not apply. In most situations, the receipt of dividends from a private corporation by a minor (under 18 years of age) are "split income" and therefore subject to the TOSI. Given this, Bert's regular 2022 net income is nil, calculated as follows:

Dividends Received	$34,000
Gross Up [(15%)($34,000)]	5,100
ITA 20(1)(ww) Deduction for Split Income	(39,100)
2022 Net Income	Nil

2022 Taxable Income

Since there are no taxable income deductions available to Bert, his 2022 net income and taxable income are both nil.

2022 Federal Income Tax Payable

While the 2022 federal income tax payable on his regular income is nil, Bert will have an addition to 2022 federal income tax payable on his split income as follows:

Split Income	$39,100
Rate	33%
Income Tax before Credit	$12,903
Dividend Tax Credit [(9/13) ($5,100)]	(3,531)
2022 TOSI (Tax on Split Income)	$ 9,372

Since Bert is under 18 years of age, Jody is jointly liable for his TOSI (ITA 160(1.2)).

Part B - Jody's Results

2022 Net Income

Jody's 2022 net income is calculated as follows:

ITA 3(a)	$128,000
Employment Income (Salary – PS World Inc.) (Note 1)	
Property Income (Note 2)	159,587
Spousal Support	25,000
ITA 3(a) total	$312,587
ITA 3(b)	
Net Taxable Capital Gains (Note 4)	100,194
Total of 3(a) + 3(b)	$412,781
ITA 3(c) – Subdivision e deductions	
Child Care Expenses (annual limit is $5,000)	(5,000)
CPP Enhanced Deduction	(461)
RRSP Deduction (Given)	(11,300)
2022 Net Income	$396,020

Note 1 [($1,500)(52 weeks) + $50,000 bonus received in 2022]. The $60,000 bonus declared at the end of 2022 will be included in Jody's income when it is received in 2023.

Note 2 Jody's property income is calculated as follows:

Non-Eligible Dividend on Pickers Ltd Shares (Note 3)	$ 40,000
Gross Up [(15%)($40,000)]	6,000
Non-Eligible Dividend on PS World Inc Shares	84,000
Gross Up [(15%)($84,000)]	12,600
Interest on share indebtedness [(5%)($200,000)(5/12)]	4,167
Dividends from U.S. Public Company [($10,000)(1.282)]	12,820
2022 Property Income	$159,587

Note 3 The dividend from Jody's parents' company, Pickers Ltd., is not subject to the TOSI. The basic analysis looks first to the type of income, which includes dividends from non-public companies (i.e., private). The next step is to determine whether the business of Pickers Ltd is a "related business", which generally means a business in which someone related to Jody is actively involved. Clearly the business that generated the dividends is a related business. The next step is to determine whether the business is an "excluded business" because of Jody's participation currently and in past years. If she participated in that business, then the TOSI would not apply. Since she made no contributions or participated in any manner, the business is not excluded. Finally, the last possible exception is whether the shares she owns in Pickers Ltd are "excluded shares". If they are then the TOSI will not apply. The shares are excluded shares because all of the conditions are met: (i) less than 90% of the company's gross revenue is from providing services, (ii) the company is not a "professional corporation", (iii) less than 10% of its business income is as a result of doing business with other related businesses, and (iv) the individual owns shares that represent more than 10% of the value of the company and shares that give the owner more than 10% of the votes. Since the shares are "excluded shares", the dividends Jody received are not subject to the TOSI.

Note 4 Jody's 2022 net taxable capital gains is calculated as follows:

Capital Gain on sale of PS World Inc shares (Note 5)		$197,988
Listed Personal Property		
Gain on Painting ($8,700 – $1,700)	$7,000	
Gain on Stamp Collection ($11,000 – $9,500)	1,500	
Gain on Rare Book ($5,000 – $1,000) (Note 6)	4,000	
Loss on Coin Collection ($11,000 – $19,000)	(8,000)	
2020 Listed Personal Property Loss	(1,200)	3,300
Net Foreign Currency Exchange Loss [($20,000)(1.25) – $26,100)		(1,100)
Foreign Currency Exemption for Individuals*		200
Net Capital Gains		$200,388
Inclusion Rate		1/2
2022 Net Taxable Capital Gain		$100,194

*The foreign currency exemption reduces the first $200 of a capital gain or capital loss.

Note 5

POD	$400,000

ACB [(25 shares)($1/each) & Selling Costs $4,000	(4,025)
Total Gain	$395,975
Less Reserve - Lesser of:	
• [($395,975)($200,000 ÷ $400,000)] = $197,987	
• [($395,975)(20%)(4 – 0)] = $316,780	(197,987)
Capital Gain	$197,988

Note 6 Even though the cost or ACB would be $250, the $1,000 rule deems the ACB to be the greater of $1,000 and its actual cost of $250. ITA 46(1)

2022 Taxable Income

Jody's 2022 taxable income would be calculated as follows:

2022 Net Income	$396,020
Capital Gains Deduction (Note 8)	(76,694)
2018, 2019 & 2020 Non-capital Losses	(60,800)
2019 Net Capital Loss	(4,500)
2022 Taxable Income	$254,026

Note 8 The maximum capital gains deduction is $76,494, calculated as the least of the following three amounts:

Capital Gains Deduction Available = $361,692

Maximum Limit On Shares [(1/2)($913,630*)]	$456,815
Less: Used In Previous Years [(1/2)($160,000)]	(80,000)
Capital Gains Deduction Available	$376,815

*This is the limit for gains on dispositions of QSBC shares for 2022. For gains on qualified farm or fishing property, the 2022 limit is unchanged at $1,000,000.

Annual Gains Limit = $95,694

This limit is equal to A - B, where

A = $98,994 [(1/2)($197,988)]

The lesser of the net taxable capital gains (see Note 4) on:

All Capital Property = $100,194
Qualifying Property [(1/2)($197,988)] = $98,994

B = $3,300

The total of:

The amount, if any, by which net capital loss carry overs deducted for the year under ITA 111(1)(b) exceeds the excess of net taxable capital gains for the year [ITA 3(b)] over the amount determined in Part A of this formula. This amount is $3,300 [$4,500 – ($100,194 – $98,994)]; and

Allowable Business Investment Losses realized during the current year. This amount is nil.

This provides an annual gains limit of $95,694 ($98,994 – $3,300).

Cumulative Gains Limit = $76,694

Annual Gains Limit from Previous Years	$160,000
Current Year Annual Gains Limit	95,694
Less: Previous Lifetime Capital Gains Deduction	(160,000)
Less: CNIL (Given - See Note 9)	(19,000)
Cumulative Gains Limit	$ 76,694

Note 9 Note that if Jody had paid herself an additional $16,522 in non-eligible dividends it would have equaled $19,000 with the gross-up of 15% and would have reduced the CNIL account to nil, allowing an additional $19,000 in capital gains deduction to be claimed.

2022 Federal Income Tax Payable

Jody's regular 2022 federal income tax payable would be determined as follows:

Tax on First $221,708		$ 51,345
Tax on Next $32,318 ($254,026 – $221,708) at 33%		10,665
2022 Federal Income Tax Payable (Before Credits)		$ 62,010
Tax Credits:		
BPA	($12,719)	
Eligible Dependant (Note 10)	Nil	
CPP	(3,039)	
Canada Employment Credit	(1,287)	
Medical Expenses (Note 11)	(9,121)	
Total Credit Base	($26,166)	
Rate	15%	(3,925)
Charitable Donation Credit (Note 12)		(4,254)
Foreign Tax Credit (Note 13)		(1,923)
Non-Eligible Dividend Tax Credit [(9/13)($6,000 + $12,600)]		(12,877)
2022 Federal Income Tax Payable – Regular		$ 39,031

Note 10 Since Jody's income exceeds $221,708 she is not entitled the fully enhanced additional $1,679 of the BPA that would permit a credit increase from $12,719 to $14,398. Bert's net income would otherwise be nil since split income is subtracted in its determination. However, for the personal tax credit purposes the split income deduction is ignored (ITA 118(4)(a.2)), which means that Bert's income is $39,100, which exceeds the eligible dependant threshold [($14,398 – $39,100)].

Note 11 Jody's medical expenses are $23,000 – $13,800 (expenses reimbursed by the insurer) + $2,400 in medical insurance premiums = $11,600.

The base for Jody's medical expense credit can be calculated as follows:

Eligible Medical Expenses	$11,600
Reduced by the Lesser of:	
• [(3%)($396,020)] = $11,881	
• 2022 Threshold Amount = $2,479	(2,479)
Total Credit Base	$ 9,121

Note 12 Jody's donations total $13,000: $1,000 for Plan Canada + $1,000 for the Humane Society + the FMV of the coin collection of $11,000. Using this as the base,

Jody's charitable donations tax credit would be calculated as follows:

15% of $200	$ 30
33% of the lesser of:	
$13,000 – $200 = $12,800	
$254,026 – $221,708 = $32,318	4,224
29% of [$13,000 – ($200 + $12,800)]	Nil
Total Credit	$ 4,254

Note 13 Jody's Adjusted Division B Income would be calculated as follows:

Net Income	$396,020
Capital Gains Deduction	(76,694)
2020 Net Capital Loss	(4,500)
Adjusted Division B Income	$314,826

Her tax otherwise payable would be calculated as follows:

Tax before Credits	$62,010
Personal Credits	(3,925)
Charitable Donation Credit	(4,254)
Tax otherwise payable	$53,831

Since the foreign non-business tax withheld is not greater than 15% of the foreign income, Jody's credit for foreign tax paid would be the lesser of the foreign tax withheld of $1,923 [(1.282)($1,500 US)] and an amount determined by the following formula:

[(Foreign Non-Business Income ÷ Adjusted Division B Income)(Tax Otherwise Payable)] = [($12,820 ÷ $314,826)($53,831)] = $2,192

As the amount withheld is the lesser of the two amounts, her non-business foreign tax credit is $1,923.

2022 Alternative Minimum Tax Payable

Jody's 2022 adjusted taxable income for alternative minimum tax purposes would be calculated as follows:

Regular Taxable Income	$254,026
60% of Net Taxable Capital Gains [(60%)($100,194)]	60,116
Dividend Gross Up [(15%)($84,000 + $40,000)]	(18,600)
Adjusted Taxable Income (For AMT)	$295,542

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

Adjusted Taxable Income	$295,542
Basic Exemption	(40,000)
Amount Subject to Tax	$255,542
Rate	15%
Minimum Tax before Credits	$ 38,331
Personal Credits	(3,925)
Charitable Donation Credit	(4,254)
2022 AMT Payable	$ 30,152

As the AMT payable of $30,152 is less than the regular federal income tax of $39,031, Jody would not be liable for any AMT in 2022.

Part C

Jody Simpson – RRSP, TFSA, and Cash Flow Considerations

Jody has asked you to consider whether she should use her TFSA or her RRSP funds if she needs additional cash to acquire the home she is currently renting. Given that the home would be her principal residence, she would be eligible to withdraw funds from her RRSP under the Home Buyers' Plan (HBP). To qualify, an individual must not have occupied a home that the individual, their spouse, or common-law partner owned within the four years preceding the withdrawal; however, this rule is generally waived in the cases of legal separation or divorce. Since the maximum withdrawal available under the HBP is only $35,000, that may not prove adequate to meet all of Jody's additional cash needs.

It would be best for her to use her TFSA funds should she need access to additional cash or if she does not qualify for the HBP. Withdrawals from her TFSA would be tax free. In addition, she will be able to return funds to her TFSA in the future, which will not be possible if funds are withdrawn from her RRSP other than through the HBP (or other qualifying programs such as the Lifelong Learning Plan).

The withdrawal of funds from her RRSP (other than for HBP or LLP) is generally not recommended since they would be required to be included in her income for that year. As Jody expects her income to remain high for years to come she would be potentially subject to the highest income tax rates. In addition, and unlike a TFSA, withdrawals of this nature would permanently reduce her contribution room without an ability to reinstate that room. This would mean smaller amounts of RRSP-based retirement income in the future.

Solution to AP 11-11

Part A - Adam's 2022 Federal Income Tax Payable

Adam's 2022 Employment Income

Adam's 2022 employment income would be calculated as follows:

Salary	$350,000
Additions:	
Travel Allowances (Note 1)	
Hotels and Food	Nil
Use of Personal Automobile	15,600
Stock Option Benefit [(1,000)($28 – $25)]	3,000
Deductions:	
Hotels and Food (Note 1)	Nil
Automobile Expenses (Note 2)	(24,924)
RPP Contributions	(12,300)
2022 Employment Income	$331,376

Note 1 Given his actual expenses, the allowance for hotels and food seems reasonable. This means it does not have to be included in income. However, this will

prevent Adam from deducting his actual expenses. While a comparison of actual expenses to the allowance received suggests that the allowance was reasonable it is not determinative. An assessment of the reasonableness of an allowance is dependent upon how it is determined in respect of the actual anticipated travel to a specific region. With respect to the allowance for personal use of his automobile, it is not based on kilometres driven and, as a result ITA 6(1)(b)(x) deems the allowance not to be reasonable requiring it to be included in employment income.

Note 2 His deductible automobile costs are calculated as follows:

Operating Expenses	$11,300
CCA on Class 10.1 [(1.5)(30%)($34,000)]	15,300
Total Automobile Costs	$26,600
Employment Related Percentage (59,000 ÷ 63,000)	93.7%
Total Deductible Expenses	$24,924

The luxury car rules limit the capital cost of the car to $34,000 for vehicles purchased on or after January 1, 2022, whether new or used, and that meet the definition of a "passenger vehicle." Passenger vehicles are "automobiles" as defined in ITA 248(1). The automobile definition contains a number of exceptions such as certain vans, pick-ups and other vehicles that are used in certain businesses. The BMW that Adam uses would not meet any of these exceptions and is therefore a passenger vehicle.

Adam's 2022 Net Income and Taxable Income

Adam's 2022 net income and taxable income can be calculated as follows:

Employment Income	$331,376
Taxable Capital Gains on Donation (Note 3)	57,500
Recapture on Donation (Note 3)	30,141
Deductible CPP ($3,500 – $3,039)	(461)
2022 Net Income	$418,556
Stock Option Deduction [(1/2)($3,000)]	(1,500)
2022 Taxable Income – Adam	$417,056

Note 3 The taxable capital gains realized on Adam's donation to the Canadian Red Cross is calculated as follows:

	Land	**Building**
POD	$75,000	$250,000
ACB	(60,000)	(150,000)
Capital Gain	$15,000	$100,000
Inclusion Rates	1/2	1/2
Taxable Capital Gains	$ 7,500	$ 50,000

The recapture on this donation is calculated as follows:

lesser of cost of $150,000 and POD of $250,000	$150,000
UCC	(119,859)
Recapture	$ 30,141

Adam's 2022 Federal Income Tax Payable

Adam's 2022 federal income tax payable would be calculated as follows:

Tax on First $221,708		$ 51,345
Tax on Next $195,348 ($417,056 – $221,708) at 33%		64,465
Federal Tax Payable (Before Credits)		$115,810
Tax Credits:		
BPA	($12,719)	
Spousal (Income too high)	Nil	
Volunteer Firefighters	(3,000)	
Transfer of Portia's Tuition – Lesser of:		
• Absolute Limit = $5,000		
• Actual Tuition = $5,400	(5,000)	
Canada Caregiver for Jack	(7,525)	
EI Premiums	(953)	
CPP Contributions	(3,039)	
Canada Employment	(1,287)	
Credit Base	($33,523)	
Rate	15%	(5,028)
Charitable Donations (Note 4)		(102,006)
2022 Federal Income Tax Payable – Adam		$ 8,776

Note 4 The maximum charitable donation that Adam can use in the current year is calculated as follows:

Net Income [(75%)($418,556)]	$313,917
Taxable Capital Gains [(25%)($57,500)]	14,375
Recapture [(25%)($30,141)]	7,535
Donation Credit Limit	$335,827

Since the limit is greater than the amount of the income tax receipt, the entire $325,000 can be used in the following calculation:

15% of $200	$ 30
33% of the lesser of:	
$325,000 – $200 = $324,800	
$417,056 – $221,708 = $195,348	64,465
29% of $129,452	
[$325,000 – ($200 + $195,348)]	37,541
Charitable Donation Credit	$102,036

Adam might consider carrying forward $129,452 of the charitable donation that is subject to the 29% donation rate if he is confident that he will have taxable income that will be subject to the 33% tax rate in a subsequent year. The credit would be 4% points larger [33% – 29%] resulting in income tax savings of $5,178. However, he would pay more income tax in the

current year in order to do this.

Part B - Estelle's 2022 Federal Income Tax Payable

Estelle's 2022 Net Income and Taxable Income

Estelle's 2022 net income and taxable income would be calculated as follows:

Non-Eligible Dividends		$ 32,000
Gross Up [(15%)($32,000)]		4,800
Taxable Capital Gain on GHI Shares [(1/2)($302,000)]	$151,000	
Allowable Capital Loss on JKL Shares (Note 5) [(1/2)($20,000)]	(10,000)	141,000
2022 Net Income		$177,800
2016 Net Capital Loss		(15,000)
Capital Gains Deduction (Note 6)		(126,000)
2022 Taxable Income – Estelle		$ 36,800

Note 5 Normally, the loss on the JKL shares would be classified as a business investment loss (BIL) and would be deductible against any type of income. However, potential BILs are reduced to the extent of the previous cumulative use of the capital gains deduction. The reduction to a potential BIL leaves the loss as a regular capital loss.

Note 6 The capital gains deduction would be the least of the following three amounts:

Capital Gains Deduction Available

Beginning Amount for 2022 [(1/2)($913,630*)]	$456,815
Amounts Used:	
[(1/2)($500,000 – $275,000)]	(112,500)
[(1/2)($623,000 – $216,000)]	(203,500)
Capital Gains Deduction Available for 2022	$140,815

*This is the limit for gains on dispositions of QSBC shares for 2022. For gains on qualified farm or fishing property, the 2022 limit would be $1,000,000.

Annual Gains Limit

Lesser of:	
• Net Taxable Capital Gains = $141,000	
• Net Taxable Capital Gains on QSBC shares only = $151,000	$141,000
2016 Net Capital Loss Deducted	(15,000)
Annual Gains Limit	$126,000

Cumulative Gains Limit

Sum of Annual Gains Limits ($112,500+ $203,500 + $126,000)	$442,000
Amounts Deducted in Previous Years ($112,500 + $203,500)	(316,000)
Cumulative Gains Limit	$126,000

The least of these amounts is $126,000.

Estelle's 2022 Federal Income Tax Payable

Tax on $36,800 at 15%		$5,520
Federal Tax		$5,520
Tax Credits		
BPA	($14,398)	
Medical Expenses (Note 7)	(4,382)	
Total	($18,780)	
Rate	15%	(2,817)
Non-Eligible Dividends Tax Credit [(9/13) ($4,800)]		(3,323)
2022 Federal Income Tax Payable - Estelle		$ Nil

Note 7 The base amount for medical expenses would be calculated as follows:

Adam, Estelle, and Portia ($1,350 + $360 + $820 + $500)		$3,030
Reduced by the Lesser of:		
• [(3%)($177,800)] = $5,334		
• 2022 Threshold Amount = $2,479		(2,479)
Jack's Medical Expenses	$4,200	
Reduced by the Lesser of:		
• [(3%)($12,300)] = $369		
• $2,479	(369)	3,831
Allowable Medical Expenses		$4,382

The fees for teeth whitening and cosmetic surgery would not be allowable medical expenses.

2022 Alternative Minimum Tax (AMT)

Because of Estelle's extensive use of the capital gains deduction, it is necessary to calculate her AMT for 2022:

Regular Taxable Income		$ 36,800
60% of Net Taxable Capital Gains [(60%)($141,000)]		84,600
Non-Eligible Dividends Gross Up		(4,800)
60% of Net Capital Loss deducted [(60%)($15,000)]		(9,000)
Adjusted Taxable Income		$107,600
AMT Exemptions		(40,000)
AMT Base		$ 67,600
Rate		15%
Federal AMT before Credits		$ 10,140
Tax Credits		
BPA	($14,398)	
Medical Expenses (Note 7)	(4,382)	

Total	($18,780)	
Rate	15%	(2,817)
Estelle's Federal AMT		$ 7,323

Estelle's 2022 federal income tax payable would be the AMT amount of $7,323 as it is larger than her regular federal income tax payable of nil. She would have a total AMT liability carry forward of $7,323 that can be carried forward to 2029 to be applied against any future excess of regular federal income tax payable over the AMT for that year.

Note that with the amount of the ITA 110.6 deduction claimed in the past, it is probable that Estelle already has an AMT amount carry forward, but no information on this is provided in the problem.

Canada Caregiver Credit - No Difference

ITA 127.531 specifies the tax credits, as calculated for the determination of regular federal income tax payable, which can be applied against the AMT. The credits specified include the following:

- Personal credits under ITA 118(1)
- Charitable donations credit under ITA 118.1
- Medical expense credit under ITA 118.2

Estelle could claim the Canada caregiver credit for Jack, but there would be no decrease of federal income tax payable for the family unit. It would decrease her AMT by the same amount as it would increase Adam's 2022 federal income tax payable.