INSTRUCTOR SOLUTIONS MANUAL

**Volume 2**

**Chapters 11-21**

**Gary Donell**

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**Byrd & Chen’s Canadian Tax Principles**

**2021-2022 Edition**

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Instructor’s Solutions Manual

Chapter 11 – Solutions to Assignment Problems

Solution to AP 11-1

###### 2018 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) ITA 3(d)  Unrestricted Farm Loss (See Note) |  | $20,360  (6,250) |
| 2018 Net Income for Tax Purposes and Taxable Income |  | $14,110 |
| **Note** Ms. Breau’s farm losses are restricted as follows: | | |
| Total Farm Loss  Unrestricted Amount: First $2,500 |  | $10,000 |
| ($ 2,500) |  |
| One-Half Of $7,500 ($10,000 – $2,500) | (3,750) | (6,250) |
| Restricted Farm Loss Carry Forward |  | $ 3,750 |

As noted in the problem, none of the losses can be carried back before 2018. This would leave the following carry forward balances at the end of 2018:

* 2018 Restricted Farm Loss $3,750
* 2018 Net Capital Loss [($2,100 (ITA 3(b)(ii)) – $600 (ITA 3)(b)(i))] $1,500

###### 2019 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  Allowable Capital Losses | $ 1,000  Nil | 1,000 |
| ITA 3(c) ITA 3(d)  Non-Farming Business Loss |  | $5,950  (14,000) |
| 2019 Net Income for Tax Purposes  2018 Net Capital Loss |  | Nil  ($1,000) |
| 2019 Taxable Income (Loss) |  | Nil |

Since there are 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 increases the 2019 non-capital loss.

The 2019 non-capital loss carry over is calculated as follows:

|  |  |  |
| --- | --- | --- |
| Business Loss | $14,000 | |
| 2018 Net Capital Loss Deducted |  | 1,000 |
| ITA 3(c) Income |  | (5,950) |
| 2019 Non-Capital Loss | $ 9,050 | |

The entire non-capital loss carry over could be carried back to 2018, but since Ms. Breau requires $14,000 in Taxable Income to fully utilize her tax credits, the maximum carry back to 2018 is only $110, calculated as follows:

|  |  |  |
| --- | --- | --- |
| 2018 Taxable Income (As Reported) | $14,110 | |
| 2019 Non-Capital Loss Carry Back |  | (110) |
| 2018 Amended Taxable Income (Minimum) | $14,000 | |

This carry back leaves Ms. Breau with her required $14,000 in Taxable Income. There would be the following carry forward balances at the end of 2019:

* + 2018 Restricted Farm Loss (Unchanged) $3,750
  + 2018 Net Capital Loss ($1,500 – $1,000)] $ 500
  + 2019 Non-Capital Loss ($9,050 – $110) $8,940

###### 2020 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

2020 Net Income For Tax Purposes $39,113

2018 Restricted Farm Loss (Equal To Farm Income) (3,150)

2018 Net Capital Loss (Less Than $2,000) (500)

2019 Non-Capital Loss Carry Forward (All) ( 8,940)

2020 Taxable Income $26,523

There would be the following carry forward balance at the end of 2020:

* + 2018 Restricted Farm Loss ($3,750 – $3,150) $ 600

###### 2021 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) ITA 3(d)  Non-Farming Business Loss |  | $ 6,450 |
| ($19,000) |  |
| Farm Loss | (2,000) | (21,000) |
| 2021 Net Income for Tax Purposes and Taxable Income |  | Nil |

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

|  |  |
| --- | --- |
| Business Loss | $19,000 |
| ITA 3(c) Income | (6,450) |
| Non-Capital Loss Carry Over | $12,550 |
| Farm Loss (Unrestricted) | 2,000 |
| 2021 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 2021 non-capital loss would be $12,550 and the 2021 Farm loss would be $2,000. The preceding loss carry over of $14,550 is available for carry back to 2020.

The 2021 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 2021 net capital loss can be applied to the 2020 year as there are $1,500 ($2,000 – $500) in net taxable capital gains remaining in 2020 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 2020, the result would be a Taxable Income of $10,473, less than the $14,000 that is required to fully utilize Ms. Breau’s available tax credits. As the 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 carry back. Based on this view, the deduction of the 2021 non-capital loss will be limited to $11,023 ($26,523 – $14,000 – $1,500), an amount that will provide for full use of Ms. Breau’s 2020 tax credits:

|  |  |
| --- | --- |
| 2020 Taxable Income (As Reported) | $26,523 |
| 2021 Non-Capital Loss | (11,023) |
| 2021 Net Capital Loss | (1,500) |
| 2020 Amended Taxable Income | $14,000 |

These carry backs leave Ms. Breau with her required $14,000 in 2020 Taxable Income. There would be the following carry forward balances at the end of 2021:

* 2018 Restricted Farm Loss $ 600
* 2021 Net Capital Loss ($5,000 – $1,500)] $3,500
* 2021 Non-Capital Loss ($14,550 – $11,023) $3,527

Solution to AP 11-2

Before consideration of any carry backs, Lucinda would have 2020 Taxable Income as follows:

|  |  |
| --- | --- |
| Rental Income | $ 91,450 |
| Interest Income | 38,275 |
| Taxable Capital Gains | 17,300 |
| 2020 Net Income for Tax Purposes 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 2019, $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 |
| ABIL | $259,500 |

Lucinda’s 2021 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)

2021 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. There would be a 2021 Net capital loss of $59,380 (ITA 3(b)(ii) $78,000 – ITA 3(b)(i)) $18,620). This net capital loss can be carried back to 2019 and applied to the extent of the net taxable capital gains of $17,300 for that year.

**Note 2** As the ABIL was realized in 2021, it must be used to reduce net income for 2021. The 2021 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 2020 would be calculated as follows:

|  |  |
| --- | --- |
| 2020 Net Income (As Originally Calculated) | $147,025 |
| 2021 Net Capital Loss | (17,300) |
| 2021 Non-capital loss | (116,496) |
| 2020 Taxable income (equal to the Basic Personal credit) | $ 13,229 |

As planned, these deductions would leave a Taxable Income of $13,229 ($147,025 – $17,300 − $116,496). The taxes on this amount will be eliminated by Lucinda’s basic personal amount. Since there was no Tax Payable prior to 2020, there would be no additional carry backs. The following carry forwards remain after the loss carry back applications:

2021 Net Capital Loss Carry Forward ($59,380 – $17,300) $42,080

2021 Non-Capital Loss Carry Forward ($145,762 – $116,496) $29,266

For the next 10 years, the ABIL will be part of the 2021 non-capital loss carry forward, Any unused amount remaining after 10 years results in the remaining part being transferred from the non-capital loss to a net capital loss in year 11.

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 that same year. The result is calculated as follows:

|  |  |
| --- | --- |
| 2021 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 |
| ABIL | $ 13,600 |

David’s 2021 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) |
| 2021 Net Income for Tax Purposes |  | | $154,600 |

David’s Taxable Income under the two different assumptions would be calculated as follows:

|  |  |  |
| --- | --- | --- |
|  | **Part A** | **Part B** |
| Net Income | $154,600 | $154,600 |
| 2017 Net Capital Loss | (5,500) | Nil |
| Capital Gains Deduction (Note) | (27,100) | (32,600) |
| Taxable Income | $122,000 | $122,000 |

**Note** As the only capital gains during 2021 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)($892,218\*)] | $446,109 | $446,109 |
| Amount Used in 2012 [(1/2)($20,000)] | (10,000) | (10,000) |
| Amount Used in 2016 [(1/2)($14,000)] | (7,000) | (7,000) |
| Amount Available | $429,109 | $429,109 |

\*This is the 2021 limit for gains on dispositions of QSBC shares. For gains on qualified farm or fishing property (QFP), the 2021 limit remains unchanged from 2020 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) |
| 2017 Net Capital Loss Deducted | (5,500) | Nil |
| 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 Previous 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 2017 $5,500 net capital loss balance, but will have $5,500 less of his capital gains deduction available for future years. His 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 and are not split income.

###### Case 3

The dividends received by Edward are not split income since the shares on which they were paid were acquired 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 dividends received in 2021 are not split income. In addition for 2021 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 2021 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 2021. 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 dividends that are in excess of the 2% safe harbour return will be Split Income.

Solution to AP 11-5

###### Part A - Taxable Income

Mr. and Mrs. Bahry’s Taxable Income would be calculated as follows:

|  |  |  |
| --- | --- | --- |
|  | **Mr. Bahry** | **Mrs. Bahry** |
| OAS (See Note) | $ 7,400 | $ 7,400 |
| RPP Receipts | 12,340 | 820 |
| RRIF Receipts | N/A | 1,000 |
| CPP Receipts | 3,690 | 830 |
| Dividends Received | 1,600 | 336 |
| Gross Up On Dividends (38%) | 608 | 128 |
| Interest On Savings Accounts | 1,239 | 3,500 |
| Net Taxable Capital Gain | Nil | Nil |
| 2021 Net Income for Tax Purposes and Taxable Income | $26,877 | $14,014 |

**Note** Neither Mr. nor Mrs. Bahry would have to repay any OAS benefits as both Net Income figures are well below the threshold income of $79,845.

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 $13,550 ($14,014 – $336 – $128). This would allow a spousal credit of $258 [$13,808 − $13,550].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 income, and therefore her 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 tax credits she can transfer.

|  |  |  |
| --- | --- | --- |
| Credits Available For Transfer: |  |  |
| Age |  | $7,713 |
| Pension (On $820 + $1,000 Only) |  | 1,820 |
| Total Available Reduced By Excess Of:  Mrs. Bahry’s Net Income |  | $9,533 |
| ($13,550) |  |
| Over Basic Personal Credit Amount | 13,808 | Nil |
| Credit Base Transferred To Spouse |  | $9,533 |

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

|  |  |
| --- | --- |
| Basic Personal Amount | $13,808 |
| Spousal Credit ($13,808 − $13,550) | 258 |
| Age (No Reduction Reequired) | 7,713 |
| Pension | 2,000 |
| Transfers From Mrs. Bahry (see preceding calculation) | 9,533 |
| Credit Base | $33,312 |
| Rate | 15% |
| Total | $ 4,997 |
| 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 | $ 5,809 |

**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 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 2021. They become 2021 net capital losses to each of them that can be carried back three years or carried forward indefinitely to be applied against taxable capital gains.

###### Part B - Pension Income Splitting

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

* it would permit Mrs. Bahry to claim 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 neither would Mr. Bahry since, with the ITA 82(3) election, his taxable income would be $27,431 [$26,877 + $464]. At a tax rate of 15% the federal gross tax payable would be $4,101 [(15%)($27,431)] which is less than his total credits of $5,809. Pension splitting could not improve this result.

Solution to AP 11-6

###### Regular Part 1 Federal Tax Payable

The minimum regular Taxable Income and net federal 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) |
| Net Income For Tax Purposes | $294,000 | $310,140 | $503,500 |
| Lifetime Capital Gains Deduction | Nil | (100,000) | (440,000) |
| Non-Capital losses | (173,000) | (60,000) | Nil |
| Taxable Income | $121,000 | $150,140 | $ 63,500 |
| Federal Tax (Note 2) | $ 23,372 | $30,948 | $ 10,321 |
| Basic Personal Credit (Note 3) | (1,863) | (1,863) | (1,863) |
| Dividend Tax Credit |  |  |  |
| (9/13 of Gross Up) | Nil | (9,762) | Nil |
| (6/11 of Gross-Up) | Nil | Nil | (5,182) |
| Net Regular Federal Tax Payable | $ 21,509 | $ 19,323 | $ 3,276 |

**Note 1** Albert’s 2021 RRSP deduction room is calculated as follows:

|  |  |
| --- | --- |
| Lesser Of: |  |
| 2021 RRSP Dollar Limit = $27,830 |  |
| 18% Of 2020 Earned Income Of $22,000 = $3,960 | $3,960 |
| Less 2020 PA | Nil |
| 2021 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.

Therese’s 2021 RRSP deduction room is calculated as follows:

|  |  |
| --- | --- |
| Unused Deduction Room - End of 2020 Annual Addition - Lesser Of:  2021 RRSP Dollar Limit = $27,830  18% of 2020 Earned Income Of $120,000 = $21,600 | $21,000  21,600 |
| Less 2020 PA | (11,600) |
| 2021 RRSP Deduction Limit | $31,000 |
| Un-deducted Contributions From Previous Years | (8,000) |
| 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 2021 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** |
| Albert | $150,140 | $17,402 + (26%)($52,100) | $30,948 |
| Milana | $121,000 | $17,402 + (26%)($22,960) | $23,372 |
| Therese | $ 63,500 | $7,353 + (20.5%)($14,480) | $10,321 |

**Note 3** Since the Net Income for Tax Purposes of all three individuals is more than $216,511 the basic personal credit for each is $1,863 [$12,421 × 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 |
| Basic Personal Credit | (1,863) | (1,863) | (1,863) |
| Federal AMT | $ 22,887 | $ 28,743 | $ 39,837 |
| Regular Federal Tax Payable | (21,509) | (19,323) | (3,276) |
| Additional Tax Required | $ 1,378 | $ 9,420 | $ 36,561 |

**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 Tax Payable for each of Milana, Albert, and Therese can be carried forward for seven years and applied against any future excess of Part 1 Tax Payable over the AMT for that year.

**Bonus Question Solution:** There 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 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 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 loss 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 the non-capital loss. 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. 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 will be 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 will result in the use of deemed POD based on FMV, thereby resulting in income tax consequences that will be reported on the 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 provisions.

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 |
| 2021 Business Income | $75,300 |

###### Property Income

Rachelle’s property income is calculated as follows:

|  |  |
| --- | --- |
| Interest Attributed From Martin (Note 1) | $ 876 |
| Net 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 |
| 2021 Property Income | $59,298 |

**Note 1** The interest 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 income for the year 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 return.

###### Net Taxable Capital Gains

Rachelle’s net taxable capital gains is 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 Carry Forward  (Note 3) (5,400) | 4,500 |
| Taxable Capital Gains | $79,500 |
| Inclusion Rate | 1/2 |
| 2021 Net Taxable Capital Gains | $39,750 |

**Note 2** Donations of publicly traded securities benefit from special rules that make gifting these assets 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 traded securities to be nil.

**Note 3** The listed personal property loss carry forward 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].

###### 2021 Net Income for Tax Purposes

Rachelle’s 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)($3,166) – $2,876] | (3,456) |
| 2021 Net Income for Tax Purposes | $170,892 |

###### Taxable Income

Rachelle’s Taxable Income would be calculated as follows:

|  |  |
| --- | --- |
| Net Income | $170,892 |
| Net Capital Loss Carry Forward (Note 4) | (89,400) |
| Taxable Income | $ 81,492 |

**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 of the available net capital loss balance can be deducted.

###### Tax Payable

Rachelle’s minimum federal Tax Payable would be calculated as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| Tax On First $49,020 |  | $ 7,353 | |
| Tax On Remaining $32,472 ($81,492 – $49,020) At 20.5% |  | 6,657 | |
| Federal Tax Before Credits |  | $ 14,010 | |
| Basic Personal Amount | ($13,808) |  | |
| Spousal ($13,808 − $2,924) (See Note 1) | (10,884) |  | |
| CPP | (2,876) |  | |
| Credit Base | ($27,568) |  | |
| Rate | 15% |  | (4,135) |
| Eligible Dividend Tax Credit [(6/11)(38%)($860)] |  |  | (178) |
| Non-Eligible Dividend Tax Credit [(9/13)(15%)($6,200)]  Charitable Donation (Note 5) |  |  | (644) |
| [(15%)($200) + (29%)($28,600 − $200)] |  | (8,266) |
| 2021 net Federal Tax Payable |  | $ 787 | |

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

Solution to AP 11-8

### Part A

###### Lyla’s Net Federal Tax Payable

Lyla’s employment income would be calculated as follows:

|  |  |
| --- | --- |
| Salary | $270,000 |
| Group Disability Plan | Nil |
| Registered Pension Plan Contributions | (12,450) |
| Deductible CPP ($3,166 – $2,876) | (290) |
| 2021 Employment Income = Taxable Income | $257,260 |

As Lyla has no other income and no taxable income deductions her employment income is equal to her taxable income. Given this, her Tax Payable would be calculated as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| Tax On First $216,511 |  |  | $50,141 |
| Tax On Next $40,749 ($257,260 – $216,511) at 33% | | | 13,447 |
| Gross Tax Payable |  |  | $63,588 |
| Basic Personal Amount | ($12,421) | |  |
| Spousal (Income Too High) | Nil | |  |
| EI Premiums | (890) | |  |
| CPP Contributions | (2,876) | |  |
| Canada Employment | (1,257) | |  |
| Medical Expenses (Note 1) | (78,579) | |  |
| Credit Base For Personal Credits | ($96,023) | |  |
| Rate | 15% | | (14,403) |
| Charitable Donations (Note 2) |  | | (52,352) |
| Lyla’s 2021 Net Federal 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%)($257,260)] = $7,718 |  |
| 2021 Limit = $2,421 | (2,421) |
| Credit Base | $78,579 |

Because a doctor has indicated the required treatment was not available in a reasonable period of time, the travel costs 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  33% of the lesser of: | $ 30 |  |
| $175,000 – $200 = $174,800  $257,260 – $216,511 = $40,749 | 13,447 |  |
| 29% of $134,051 [$175,000 – ($200 + $40,749)] | 38,875 |  |
| Total Credit | $ 52,352 |  |

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) |
| 2021 Property Income = 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 would also be his taxable income. Given this, his net federal tax payable would be calculated as follows:

|  |  |  |
| --- | --- | --- |
| Tax On First $216,511 | | $ 50,141 |
| Tax On Next $64,769 ($281,280 – $216,511) at 33% | | 21,374 |
| Gross Tax Payable  Basic Personal Amount ($12,421) Spousal (Income Too High) Nil | | $ 71,515 |
| Credit Base For Personal Credits | ($12,421) |  |
| Rate | 15% | (1,863) |
| Dividend Tax Credit [(6/11)(38%)($136,000)] |  | (28,189) |
| Clark’s 2021 Net Federal Tax Payable |  | $ 41,463 |

###### Combined Net Federal Tax Payable

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

Lyla’s Net Federal Tax Payable Nil

Clark’s Net Federal Tax Payable $41,463

Combined Net Federal Tax Payable $41,463

### Part B

###### Lyla’s Net Federal Tax Payable

If Lyla did not claim the medical expenses and charitable donation amounts, her Taxable Income would be unchanged from Part A. Based on this, her federal Tax Payable would be calculated as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| Tax On First $216,511 |  |  | $ 50,141 |
| Tax On Next $40,749 ($257,260 – $216,511) at 33% | | | 13,447 |
| Gross Tax Payable |  |  | $ 63,588 |
| Basic Personal Amount ($12,421)  Spousal (Income Too High) Nil | | | |
| EI Premiums |  | (890) |  |
| CPP Contributions |  | (2,876) |  |
| Canada Employment |  | (1,257) |  |
| Credit Base For Personal Credits | ($17,444) | |  |
| Rate |  | 15% | (2,617) |
| Lyla’s 2021 Net Federal Tax Payable |  |  | $ 60,971 |

If Clark claims the medical and charitable donations amounts, his Taxable Income would be unchanged from Part A. Based on this, his federal Tax Payable would be calculated as follows:

|  |  |  |
| --- | --- | --- |
| Tax On First $216,511 | $ 50,141 | |
| Tax On Next $64,769 ($281,280 – $216,511) at 33% |  | 21,374 |
| Gross Tax Payable  Basic Personal Amount ($12,421) Spousal (Income Too High) Nil Medical Expense Tax Credit (Note 3) (78,579) | $ 71,515 | |
| Credit Base For Personal Credits ($91,000)  Rate 15% |  | (13,650) |
| Dividend Tax Credit [(6/11)(38%)($136,000)] |  | (28,189) |
| Charitable Donations Tax Credit (Note 4) |  | (53,283) |
| Clark’s Federal 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 |  |  |
| 2021 Limit = $2,421 |  | (2,421) |
| Credit Base |  | $78,579 |

**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 – $216,511 = $64,769 | 21,374 |
| 29% of $110,031 [$175,000 – ($200 + $64,769)] | 31,909 |
| Total Credit | $53,283 |

###### Combined Net Federal Tax Payable

The couple’s combined Tax Payable, assuming that Clark claims all of the medical expenses and charitable donations, would be as follows:

|  |  |
| --- | --- |
| Lyla’s Net Federal Tax Payable | $60,971 |
| Clark’s Net Federal Tax Payable | Nil |
| Combined Net Federal Tax Payable | $60,971 |

###### Part C

The combined net federal tax payable in Part B is $19,508 ($60,971 – $41,463) higher than in Part A. This is despite the fact that Clark’s charitable donation credit is $931 ($53,283 – $52,352) larger than Lyla’s.

The difference is due to unused credits. In Part A, $3,167 in credits available to Lyla are not used. In Part B, $23,607 in credits available to Clark are not used.

In looking to reduce combined net federal 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, $134,051 when Lyla claims the entire amount, and $110,031 when Clark claims the entire amount.

This would suggest that Lyla should claim all of the medical expenses and $40,749 ($257,260 – $216,511 + $200) of the donations. Based on this, her net federal tax payable would be as follows:

|  |  |  |
| --- | --- | --- |
| Tax On First $216,511 |  | $50,141 |
| Tax On Next $40,749 ($257,260 – $216,511) at 33% |  | 13,447 |
| Gross Tax Payable |  | $63,588 |
| Basic Personal Amount | ($ 12,421) |  |
| Spousal (Income Too High)  EI Premiums | Nil  (890) |  |
| CPP Contributions | (2,876) |  |
| Canada Employment | (1,257) |  |
| Medical Expenses (As In Part A and B) | (78,579) |  |
| Credit Base For Personal Credits | ($ 96,023) |  |
| Rate | 15% | (14,403) |
| Charitable Donations (Note 5) |  | (13,381) |
| Lyla’s 2021 Net Federal Tax Payable |  | $35,804 |

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

|  |  |
| --- | --- |
| 15% of $200 | $ 30 |
| 33% of the lesser of: |  |
| $40,749 – $200 = $40,549 |  |
| $257,260 – $216,511 = $40,749 | 13,381 |
| 29% of Nil [$40,749 – ($200 + $40,549)] | Nil |
| Total Credit | $13,381 |

This would leave $134,251 ($175,000 – $40,749) of the donations to be claimed by Clark. Based on this, his net federal tax payable would be calculated as follows:

|  |  |  |
| --- | --- | --- |
| Tax On First $216,511 | | $50,141 |
| Tax On Next $64,769 ($281,280 – $216,511) at 33% | | 21,374 |
| Tax Before Credits  Basic Personal Amount ($12,421)  Spousal (Income Too High) Nil | | $71,515 |
| Credit Base For Personal Credits | ($12,421) |  |
| Rate | 15% | (1,863) |
| Dividend Tax Credit [(6/11)(38%)($136,000)] |  | (28,189) |
| Charitable Donations Tax Credit (Note 6) |  | (41,466) |
| Clark’s 2021 Net Federal Tax Payable |  | $ Nil |

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

|  |  |
| --- | --- |
| 15% of $200  33% of the lesser of: | $ 30 |
| $134,251 – $200 = $134,051  $281,280 – $216,511 = $64,769 | 21,374 |
| 29% of $69,282 [$134,251 – ($200 + $64,769)] | 20,092 |
| Total Credit | $ 41,466 |

###### Combined 2021 Net Federal Tax Payable

The couple’s combined Tax Payable, for all three parts, would be as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Part A** | **Part B** | **Part C** |
| Lyla’s Net Federal Tax Payable | Nil | $60,971 | $35,804 |
| Clark’s Net Federal Tax Payable | $41,463 | Nil | Nil |
| Combined 2021 Net Federal Tax Payable | $41,463 | $60,971 | $35,804 |

The combined 2021 net federal Tax Payable in Part C is less than that for Part A and a significant improvement over the combined federal 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 $69,262 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 2021.

###### 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 net income tax liability.

Solution to AP 11-9

###### 2021 Net Income and Taxable Income

Ms. Arsenault’s minimum Net Income for Tax Purposes 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 |
| Net Taxable Capital Gains |  |  |
| Lintz Shares [(1/2)($105,000 – $95,000 – $850)] | $ 4,575 |  |
| Employer’s Shares (Note Five) | (175) | 4,400 |
| Other Sources Of Income (Subdivision d) |  |  |
| Child Support (Note Six) |  | Nil |
| Other Deductions From Income (Subdivision e) |  |  |
| Moving Expenses (Note Two) | ($ 5,160) |  |
| Child Care Costs (Note Seven) | (7,660) |  |
| RRSP Contributions (Note Eight) | (10,098) |  |
| Deductible CPP Contributions ($3,166 – $2,876) | (290) | (23,208) |
| 2021 Net Income |  | $121,667 |
| Stock Option Deduction (Note One) |  | (5,000) |
| 2021 Taxable Income |  | $116,667 |

**Note One** The required inclusion would be calculated as follows:

|  |  |
| --- | --- |
| FMV at Exercise [($20)(2,000 Shares)]  Cost Of Shares [($15)(2,000 Shares)] | $40,000  (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.

**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 Net Income For Tax Purposes:

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 a 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 taxes on the $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 costs 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 2020 | Nil |
| Lesser Of: |  |
| * 2021 RRSP Dollar Limit = $27,830 |  |
| * 18% Of 2020 Earned Income Of $81,100 = $14,598 | $14,598 |
| Less 2020 PA | (4,500) |
| Maximum Deductible RRSP Contribution For 2021 | $10,098 |

###### Tax Payable

The TOSI Payable is calculated as follows:

|  |  |
| --- | --- |
| Split Income – Taxable Non–Eligible Dividends (Note Three) | $11,500 |
| Tax Rate | 33% |
| Tax 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 $98,040 |  | $17,402 |
| Tax on Next $18,627 ($116,667 – $98,040) at 26% |  | 4,843 |
| Total Before Credits |  | $22,245 |
| Basic Personal Amount | ($13,808) |  |
| Eligible Dependant – Jerry (Note Nine) | (13,808) |  |
| Canada Caregiver – Janine (Note Ten) | (7,348) |  |
| CPP | (2,876) |  |
| EI | (890) |  |
| Canada Employment | (1,257) |  |
| Transfer Of Janine’s Disability | (8,662) |  |
| Medical Expenses (Note Eleven) | (15,249) |  |
| First Time Home Buyers’ Plan | (5,000) |  |
| Credit Base | ($68,898) |  |
| Rate | 15% | (10,335) |
| Non-Eligible Dividend Tax Credit [(9/13)($1,125)]  Charitable Donations  [(15%)($200) + (29%)($1,500 – $200)] |  | (779)  (407) |
| Political Contributions Tax Credit |  |  |
| [(3/4)($400) + (1/2)($350) + (1/3)($150)] | (525) | |
| 2021 Net Regular Federal Tax Payable | $10,199 | |
| 2021 TOSI Payable (See Previous Calculation) | 2,757 | |
| CPP Overpayment ($3,166 + $500 – $3,166) | (500) | |
| EI Overpayment ($890 + $390 – $890) | (390) | |
| Amount Owing To The CRA | $12,066 | |

**Note Nine** Although Ms. Arsenault can claim either Jerry or Janine as an eligible dependant, she should pick Jerry because he has no income. 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)  Threshold - Lesser Of: | | $10,600 |
| * [(3%)($121,667)] = $3,650 * 2021 Limit = $2,421 |  | (2,421) |
| Subtotal  Janine’s Medical Expense Reduced By The Lesser Of: | $7,250 | $ 8,179 |
| * [(3%)($6,000)] = $180 |  |  |
| * 2021 Limit = $2,421 | (180) | 7,070 |
| Allowable Medical Expenses |  | $15,249 |

Solution to AP 11-10

**Part A - Bert’s Results**

###### Net Income

**Note:** If both the TOSI and attribution rules would apply to the same amount a rule in ITA 74.5(13) that 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 2021 Net Income for Tax Purposes 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) |
| 2021 Net Income for Tax Purposes | Nil |

###### Taxable Income

Since net income for tax purposes and taxable income can never be negative, Bert’s regular taxable income is also nil.

###### Tax Payable

While the Tax Payable on his regular income is nil, Bert will have an addition to Tax Payable on his split income as follows:

|  |  |
| --- | --- |
| Split Income | $39,100 |
| Rate | 33% |
| Tax Before Credit | $12,903 |
| Dividend Tax Credit [(9/13) ($5,100)] | (3,531) |
| Tax Payable On Split Income | $ 9,372 |

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

### Part B - Jody’s Results

###### Net Income

Jody’s Net Income for Tax Purposes is calculated as follows:

|  |  |
| --- | --- |
| Employment Income (Salary – PS World Inc.) (Note 1) | $128,000 |
| Property Income (Note 2) | 159,587 |
| Net Taxable Capital Gains (Note 4) | 100,194 |
| Spousal Support | 25,000 |
| Child Care Expenses (annual limit is $5,000) | (5,000) |
| CPP Enhanced Deduction (Note 7) | (290) |
| RRSP Deduction (Given) | (11,300) |
| Net Income for Tax Purposes | $396,191 |

**Note 1** [($1,500)(52 weeks) + $50,000 bonus received in 2021]. The $60,000 bonus declared at the end of 2021 will be included in Jody’s income when it is received in 2022.

**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 Share indebtedness [(5%)($200,000)(5/12)] | 4,167 |
| Dividends From U.S. Public Company [($10,000)(1.282)] | 12,820 |
| 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 net taxable capital gains is calculated as follows:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Capital Gain On sale of PS World Inc shares (Note 5)  Listed Personal Property | |  | | $197,988 | |
| 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) | |  | |
| Listed Personal Property Loss Carry Forward | (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 | |
| Net Taxable Capital Gain | |  | | $100,194 | |

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

**Note 5**

Proceeds Of Disposition $400,000

Adjusted Cost Base [(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)

**Note 7** The maximum CPP insurable earnings for 2021 is $58,100 [$61,600 – $3,500]. The contribution rate is 5.45%, up from 4.95% in previous years. The difference represents an enhancement the federal government believed necessary to sustain the CPP program. In order to reduce the impact, the government opted to allow an expense for the enhancement with a tax credit for the remainder. The result is that what would have been a tax credit of $3,166 [(5.45%)($58,100)] is now split between a tax credit of $2,876 [(4.95%)($58,100)] with the remaining $290 treated as an expense deductible under Subdivision e in a manner similar to that of deductions for RRSP contributions and child care expenses.

###### Taxable Income

Jody’s Taxable Income would be calculated as follows:

|  |  |
| --- | --- |
| Net Income for Tax Purposes | $396,191 |
| Capital Gains Deduction (Note 8) | (76,694) |
| 2017, 2018 & 2019 Non-capital Losses | (60,800) |
| 2018 Net Capital Loss | (4,500) |
| 2021 Taxable Income | $254,197 |

**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)($892,218\*)] | $446,109 |
| Less: Used In Previous Years [(1/2)($160,000)] | (80,000) |
| Capital Gains Deduction Available | $366,109 |

\*This is the limit for gains on dispositions of QSBC shares for 2021. For gains on qualified farm or fishing property, the 2021 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 = $76,494

|  |  |
| --- | --- |
| 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.

###### 

###### Tax Payable

Jody’s regular Tax Payable would be determined as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| Tax On First $216,511 |  | $ 50,141 |  |
| Tax on Next $37,686 ($254,197 – $216,511) at 33% |  | 12,436 |  |
| Gross Tax Payable |  | $ 62,577 |  |
| Tax Credits: |  |  |  |
| Basic Personal | ($12,421) |  |  |
| Eligible Dependant (Note 10) | Nil |  |  |
| CPP | (2,876) |  |  |
| Canada Employment Credit | (1,257) |  |  |
| Medical Expenses (Note 11) | (9,179) |  |  |
| Total Credit Base | ($25,733) |  |  |
| Rate | 15% | (3,860) |  |
| 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) |  |
| Net Federal Tax Payable – Regular |  | $ 39,663 |  |

**Note 10** Since Jody’s income exceeds $216,511 she is not entitled the fully enhanced additional $1,387 of basic personal amount that would permit a credit increase from $12,421 to $13,808. 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 [($13,808 – $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%)($396,191)] = $11,886
* 2021 Threshold Amount = $2,421 (2,421)

Total Credit Base $ 9,179

**Note 12** Jody’s donations total $13,000: $1,000 for Plan Canada + $1,000 for the Humane Society + the fair market value 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  33% of the lesser of: | $ 30 |
| $13,000 – $200 = $12,800 |  |
| $254,197 – $216,511 = $37,686 | 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 | $396,191 |
| Capital Gains Deduction | (76,694) |
| Net Capital Loss Deducted | (4,500) |
| Adjusted Division B Income | $314,997 |

Her Tax Otherwise Payable would be calculated as follows:

|  |  |
| --- | --- |
| Tax Before Credits | $62,577 |
| Personal Credits | (3,860) |
| Charitable Donation Credit | (4,254) |
| Tax Otherwise Payable | $54,463 |

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 [(15%)(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 ÷ $314,997)($54,463)] = $2,217

As the amount withheld is the lesser of the two figures, her foreign tax credit is $1,923.

###### Alternative Minimum Tax Payable

Jody’s adjusted Taxable Income for alternative minimum tax purposes would be calculated as follows:

|  |  |
| --- | --- |
| Regular Taxable Income | $254,197 |
| 60% of Net Taxable Capital Gains [(60%)($100,194)] | 60,116 |
| Dividend Gross Up [(15%)($60,000)] | (18,600) |
| Adjusted Taxable Income (For AMT) | $295,713 |

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

|  |  |
| --- | --- |
| Adjusted Taxable Income | $295,713 |
| Basic Exemption | (40,000) |
| Amount Subject To Tax | $255,713 |
| Rate | 15% |
| Minimum Tax Before Credits | $ 38,357 |
| Personal Credits | (3,860) |
| Charitable Donation Credit | (4,254) |
| AMT Payable | $ 30,243 |

As the AMT payable of $30,243 is less than the regular Tax Payable of $39,663, Jody would not be liable for any AMT.

### 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 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 tax rates. In addition, and unlike a TFSA, withdrawals of this nature would permanently draw down 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 Federal Tax Payable

###### Adam’s Employment Income

Adam’s 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 Costs (Note 2) (23,238)

RPP Contributions (12,300)

Net Employment Income $333,062

**Note 1** Given his actual costs, 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 costs. While a comparison of actual costs 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 Costs Paid | $11,300 |
| CCA On Class 10.1 [(1.5)(30%)($30,000)] | 13,500 |
| Total Automobile Costs | $24,800 |
| Employment Related Percentage (59,000 ÷ 63,000) | 93.7% |
| Total Deductible Costs | $23,238 |

The luxury car rules limit the capital cost of the car to $30,000 for vehicles purchased during 2021 that are “passenger vehicles”. 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 Net And Taxable Income

Adam’s Net Income and Taxable Income can be calculated as follows:

|  |  |
| --- | --- |
| Employment Income | $333,062 |
| Taxable Capital Gains On Donation (Note 3) | 57,500 |
| Recapture On Donation (Note 3) | 30,141 |
| Deductible CPP ($3,166 – $2,876) | (290) |
| Net Income For Tax Purposes | $420,413 |
| Stock Option Deduction [(1/2)($3,000)] | (1,500) |
| Taxable Income – Adam | $418,913 |

**Note 3** The taxable capital gains realized on Adam’s donation to the 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 $150,000 and $250,000 |  | $150,000 |
| January 1, 2021, UCC |  | (119,859) |
| Recapture |  | $ 30,141 |

###### 

###### Adam’s net federal tax payable

Adam’s net federal Tax Payable would be calculated as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| Tax On First $216,511 |  |  | $ 50,141 |
| Tax On Next $202,402 ($418,913 – $216,511) at 33% | | | 66,793 |
| Gross Tax Payable |  |  | $116,934 |
| Tax Credits:  Basic Personal Amount | | ($12,421) |  |
| Spousal (Income Too High) | | Nil |  |
| Volunteer Firefighters  Transfer Of Portia’s Tuition – Lesser Of: |  | (3,000) |  |
| * Absolute Limit = $5,000 * Actual Tuition = $5,400 |  | (5,000) |  |
| Canada Caregiver For Jack |  | (7,348) |  |
| EI Premiums |  | (890) |  |
| CPP Contributions |  | (2,876) |  |
| Canada Employment |  | (1,257) |  |
| Credit Base | ($32,792) | |  |
| Rate | 15% | | (4,919) |
| Charitable Donations (Note 4) |  | | (102,288) |
| 2021 Net Federal Tax Payable – Adam |  | | $ 9,727 |

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

|  |  |
| --- | --- |
| Net Income [(75%)($420,413)] | $315,310 |
| Taxable Capital Gains [(25%)($57,500)] | 14,375 |
| Recapture [(25%)($30,141)] | 7,535 |
| Limit | $337,220 |

Since the limit is greater than the amount of the 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

$418,913 – $216,511 = $202,402 66,793

29% of $122,398

[$325,000 – ($200 + $202,402)] 35,495

Charitable Donation Credit $102,288

Adam might consider carrying forward $122,398 of the charitable donation if he is confident that he will have Taxable Income that will be taxed at 33% in the subsequent year. The credit would be 4% points larger [33% – 29%]. However, he would pay more taxes in the current year in order to do this.

### Part B - Estelle’s Federal Tax Payable

###### Estelle’s Net And Taxable Income

Estelle’s Net Income and Taxable Income would be calculated as follows:

|  |  |  |
| --- | --- | --- |
| Non-Eligible Dividends |  | $ 32,000 |
| Gross Up [(15%)($32,000)]  Taxable Capital Gain on GHI Shares [(1/2)($302,000)] |  | 4,800 |
| $151,000 |  |
| Allowable Capital Loss On JKL Shares |  |  |
| (Note 5) [(1/2)($20,000)] | (10,000) | 141,000 |
| 2021 Net Income |  | $177,800 |
| 2015 Net Capital Loss |  | (15,000) |
| Capital Gains Deduction (Note 6) |  | (126,000) |
| 2021 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:

**Amount Available**

|  |  |
| --- | --- |
| Beginning Amount For 2021 [(1/2)($892,218\*)]  Amounts Used: | $446,109 |
| [(1/2)($500,000 – $275,000)] | (112,500) |
| [(1/2)($623,000 – $216,000)] | (203,500) |
| **Amount Available** | $130,109 |

\*This is the limit for gains on dispositions of QSBC shares for 2021. For gains on qualified farm or fishing property, the 2021 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 |
| 2015 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, the amount available.

###### Estelle’s Tax Payable

|  |  |  |
| --- | --- | --- |
| Tax On $36,800 at 15% |  | $5,520 |
| Gross Tax  Tax Credits  Basic Personal Credit |  | $5,520 |
| ($13,808) |  |
| Medical Expenses (Note 7) | (4,440) |  |
| Total | ($18,248) |  |
| Rate | 15% | (2,737) |
| Non-Eligible Dividends Tax Credit [(9/13) ($4,800)] | | (3,323) |
| 2021 Net Federal 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 |  |  |
| * 2021 Threshold Amount = $2,421 |  | (2,421) |
| Jack’s Medical Expenses | $4,200 |  |
| Reduced By The Lesser Of: |  |  |
| * [(3%)($12,300)] = $369 |  |  |
| * $2,421 | (369) | 3,831 |
| Allowable Medical Costs |  | $4,440 |

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

###### Alternative Minimum Tax (AMT)

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

|  |  |  |
| --- | --- | --- |
| 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 Tax Credits  Basic Personal Credit ($13,808)  Medical Expenses (Note 7) (4,440) | $ 10,140 | |
| Total ($18,248)  Rate 15% |  | (2,737) |
| Estelle’s Federal AMT | $ 7,403 | |

Estelle’s Tax Payable would be the AMT amount of $7,403 as it is larger than her regular Tax Payable. As her the regular tax payable is nil she would have a total AMT liability carry forward of $7,403.

This excess can be carried forward for up to seven years to be applied against any future excess of regular Tax Payable over the alternative minimum tax.

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 Tax Payable, which can be applied against the alternative minimum tax. 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 Tax Payable for the family unit. It would decrease her federal Tax Payable and the AMT by the same amount as it would increase Adam’s Tax Payable.